



# The 2020 Long-Term Budget Outlook

## Overview

By the end of 2020, federal debt held by the public is projected to equal 98 percent of gross domestic product (GDP)—its highest level since shortly after World War II. If current laws governing taxes and spending generally remained unchanged, debt would first exceed 100 percent of GDP in 2021 and would reach 107 percent of GDP, its highest level in the nation's history, by 2023, the Congressional Budget Office projects.

Debt would continue to increase in most years thereafter, reaching 195 percent of GDP by 2050 (see Figure 1). That amount of debt would be the highest by far in the nation's history, and it would be on track to increase further. High and rising federal debt makes the economy more vulnerable to rising interest rates and, depending on how that debt is financed, rising inflation. The growing debt burden also raises borrowing costs, slowing the growth of the economy and national income, and it increases the risk of a fiscal crisis or a gradual decline in the value of Treasury securities.

## What CBO's Projections Represent

The long-term projections of federal spending, revenues, deficits, and debt in this report are consistent with the 10-year baseline budget projections that CBO published earlier this month, which incorporate the effects of legislation enacted through August 4, 2020, and the economic forecast that the agency published in July 2020.<sup>1</sup> Those projections incorporate the budgetary and economic effects of the 2020 coronavirus pandemic and associated measures taken to limit in-person interactions. They also reflect the economic and budgetary effects of laws enacted to address the public health emergency and to support households, businesses, and

state and local governments.<sup>2</sup> In CBO's assessment, the economic effects of those laws will partially offset the deterioration in economic conditions brought about by the pandemic.<sup>3</sup>

CBO's long-term projections extend most of the concepts underlying its 10-year budget projections for an additional 20 years, and they reflect the macroeconomic effects of projected fiscal policy over that 30-year period. Together, those long-term projections constitute the agency's *extended baseline* projections.<sup>4</sup>

CBO's 10-year and extended baseline projections are not predictions of budgetary outcomes. Rather, they represent the agency's best assessment of future spending, revenues, deficits, and debt under these assumptions:

- Current laws affecting revenues and spending generally remain unchanged;
- Some programs—for example, the Supplemental Nutrition Assistance Program (SNAP)—are

1. See Congressional Budget Office, *An Update to the Budget Outlook: 2020 to 2030* (September 2020), [www.cbo.gov/publication/56517](http://www.cbo.gov/publication/56517), and *An Update to the Economic Outlook: 2020 to 2030* (July 2020), [www.cbo.gov/publication/56442](http://www.cbo.gov/publication/56442). Budgetary values, such as the ratio of debt or deficits to gross domestic product, are calculated on a fiscal year basis; economic variables, such as gross national product or interest rates, are calculated on a calendar year basis.

2. The laws enacted in response to the pandemic include the Coronavirus Preparedness and Response Supplemental Appropriations Act, 2020 (Public Law 116-123, enacted on March 6, 2020), the Families First Coronavirus Response Act (P.L. 116-127, enacted on March 18, 2020), the Coronavirus Aid, Relief, and Economic Security Act (P.L. 116-136, enacted on March 27, 2020), the Paycheck Protection Program and Health Care Enhancement Act (P.L. 116-139, enacted on April 24, 2020), and the Paycheck Protection Program Flexibility Act of 2020 (P.L. 116-142, enacted on June 5, 2020).

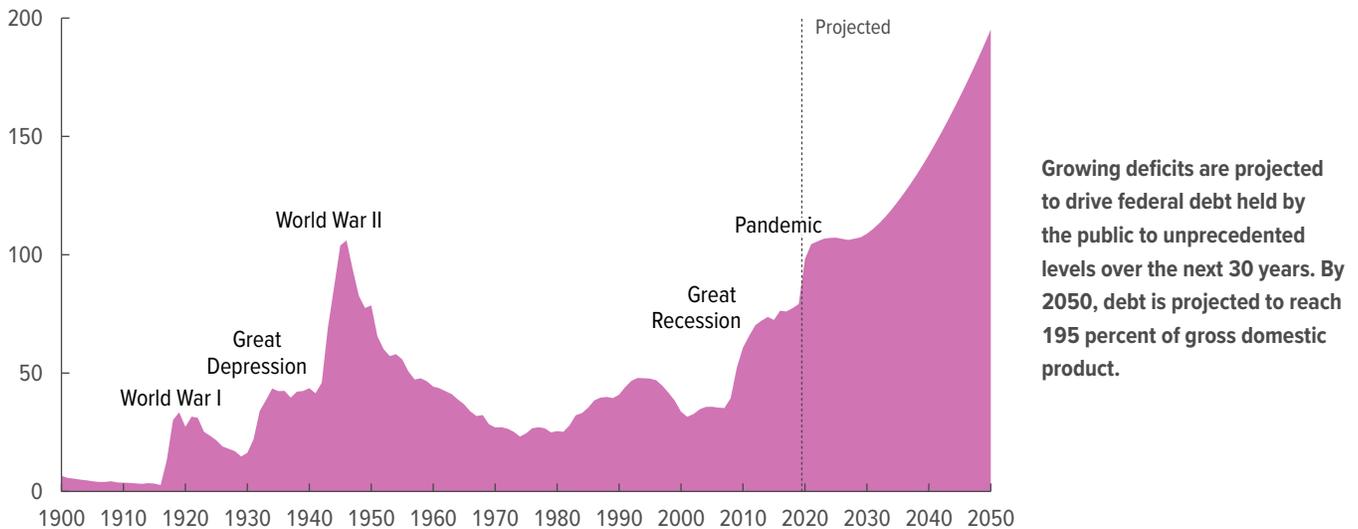
3. See Congressional Budget Office, *The Effects of Pandemic-Related Legislation on Output* (September 2020), [www.cbo.gov/publication/56537](http://www.cbo.gov/publication/56537).

4. CBO's projections are also based on assumptions about the Federal Reserve's implementation of monetary policy. The projections and discussion in this report do not reflect recent updates to that policy. See Board of Governors of the Federal Reserve System, "Federal Open Market Committee Announces Approval of Updates to Its Statement on Longer-Run Goals and Monetary Policy Strategy" (press release, August 27, 2020), <https://go.usa.gov/xGXXn>.

Figure 1.

**Federal Debt Held by the Public, 1900 to 2050**

Percentage of Gross Domestic Product



Source: Congressional Budget Office.

nevertheless extended after their authorizations lapse; and

- Spending for Medicare and Social Security continues as scheduled even after their trust funds are exhausted.

In making those assumptions, which are specified in law, CBO produces its baseline projections to give lawmakers a point of comparison from which to measure the effects of policy options or proposed legislation.

In most years, CBO examines budgetary outcomes under both the extended baseline and an extended alternative fiscal scenario. Under the alternative fiscal scenario, current law would be changed to maintain certain policies that are now in place. In order to release this report when it would be most useful to the Congress, CBO examines budgetary outcomes for the extended baseline only in this report. The agency expects to examine budgetary outcomes under both the extended baseline and an alternative fiscal scenario in the next report in this series.

**Why Federal Debt Has Grown in Recent Years**

Debt held by the public is the amount of money that the federal government has borrowed in financial markets by

issuing Treasury securities—including those held by the Federal Reserve—to pay for its operations and activities. Debt as a percentage of GDP is a useful measure for comparing amounts of debt in different years because it shows debt in relation to the size of the economy. That measure places the effects of potential adjustments to the budget within the context of the nation's resources. If debt as a percentage of GDP rises indefinitely, then debt will become unsustainable because the costs of financing deficits and servicing the debt will consume an ever-growing proportion of the nation's income. In particular, when the economy is operating close to its potential output, the Federal Reserve in all likelihood will not be able to extensively support government borrowing without increasing expected inflation and causing an erosion of confidence in the U.S. dollar as an international reserve currency.

Federal debt held by the public has increased significantly in recent years. At the end of 2007, federal debt was 35 percent of GDP. Deficits arising from the 2007–2009 recession and from policies implemented to counter the effects of the downturn caused debt to grow in relation to the economy over the next five years. By the end of 2012, debt as a share of GDP had doubled,

reaching 70 percent, and it has climbed since then, reaching 79 percent by 2019.

In the first quarter of 2020, the coronavirus pandemic ended the longest economic expansion in U.S. history and triggered the deepest downturn in output and employment since the demobilization following World War II. Increased spending and decreased revenues associated with the pandemic and ensuing recession have created a challenging budgetary situation, putting debt held by the public on track to reach an estimated 98 percent of GDP by the end of this year (see Table 1). By historical standards, that amount of debt is very high. Over the past 50 years, debt has averaged 43 percent of GDP. It has exceeded 98 percent of GDP in only two years in U.S. history—when debt reached 106 percent of GDP following the surge in federal spending as a result of World War II.

### Why Debt Is Projected to Continue to Grow

Debt as a percentage of GDP is projected to increase in most years as the government incurs budget deficits that are large relative to the growth of the economy (see Figure 2). If current laws generally remained unchanged, federal budget deficits would be substantially larger over the next 30 years than they were over the past 50 years. In CBO's projections, deficits rise after 2030 as mandatory spending—in particular, outlays for the major health care programs—and interest payments on federal debt grow faster than revenues (see Figure 3 on page 10).<sup>5</sup> That growth in deficits causes projected debt to rise as a percentage of GDP over the 2030–2050 period.

**Deficits From 2020 to 2030.** At an estimated 16.0 percent of GDP, the deficit in 2020 is the largest it has been since the end of World War II, including the years during and immediately following the 2007–2009 recession. In CBO's projections, deficits fall to 8.6 percent of GDP in 2021 and continue to fall through 2027. Deficits increase again in the last few years of the decade, reaching 5.3 percent of GDP in 2030. That level is historically high and more than one-and-a-half times the average over the past 50 years (3.0 percent of GDP).

5. Mandatory, or direct, spending includes outlays for some federal benefit programs and for certain other payments to people, businesses, nonprofit institutions, and state and local governments. Such outlays are generally governed by statutory criteria and are not normally constrained by the annual appropriation process.

In CBO's projections, mandatory spending decreases from 22.4 percent of GDP in 2020 to 14.2 percent of GDP in 2024, primarily because of declining spending related to the pandemic. In most years thereafter, mandatory spending rises, reaching 15.1 percent of GDP in 2030. Those increases in mandatory spending stem from the aging of the population, which causes the number of participants in Social Security to grow faster than the overall population, and growth in federal health care costs per beneficiary that exceeds the growth in GDP per capita. From 2025 to 2030, increased mandatory spending as a percentage of GDP is responsible for much of the increase in deficits over that period. Discretionary spending, which is generally projected to keep pace with inflation, decreases in relation to the size of the economy over the decade, from 8.0 percent of GDP in 2020 to 5.8 percent in 2030.<sup>6</sup> Revenues rise from 16.0 percent of GDP in 2020 to 17.8 percent in 2030; roughly half of that increase comes from the scheduled increases in taxes at the end of calendar year 2025.

As a result of those changes in spending and revenues, primary deficits (which exclude net spending for interest) fall in most years in CBO's projections, from 14.4 percent of GDP in 2020 to 3.1 percent of GDP in 2030. In CBO's projections, federal debt rises over most of the 2020–2030 period. However, net outlays for interest decline from 1.6 percent of GDP in 2020 to 1.1 percent in 2024 and 2025 as interest rates, which have fallen in recent months, remain low. Interest rates are projected to rise over time as the economy expands. Because federal debt remains high, net outlays for interest rise to 2.2 percent of GDP in 2030.

**Deficits From 2030 to 2050.** In the second and third decades of CBO's projection period, deficits grow from 5.3 percent of GDP in 2030 to 9.0 percent by 2040 and 12.6 percent by 2050. Over that 20-year period, deficits average 9.0 percent of GDP, which is much higher than their 50-year average of 3.0 percent of GDP.

After 2030, mandatory spending continues to increase faster than economic output, reaching 16.6 percent of GDP in 2040 and 17.5 percent in 2050, whereas

6. Discretionary spending encompasses an array of federal activities that are funded through or controlled by appropriations. That category includes most defense spending, outlays for highway programs, and spending for many other nondefense activities, such as elementary and secondary education, housing assistance, international affairs, and the administration of justice.

Table 1.

**Key Projections in CBO's Extended Baseline**

Percentage of Gross Domestic Product

	2020	Projected Annual Average		
		2021–2030	2031–2040	2041–2050
<b>Revenues</b>				
Individual income taxes	7.4	8.8	9.7	10.1
Payroll taxes	6.4	6.0	5.8	5.7
Corporate income taxes	0.7	1.2	1.2	1.3
Other <sup>a</sup>	1.4	1.4	1.2	1.3
<b>Total Revenues</b>	<b>16.0</b>	<b>17.5</b>	<b>17.9</b>	<b>18.4</b>
<b>Outlays</b>				
Mandatory				
Social Security	5.3	5.7	6.2	6.3
Major health care programs <sup>b</sup>	6.1	6.4	7.7	8.8
Other	11.0	2.6	2.2	2.0
Subtotal	22.4	14.8	16.1	17.2
Discretionary	8.0	6.3	5.6	5.6
Net interest	1.6	1.5	3.8	6.5
<b>Total Outlays</b>	<b>32.0</b>	<b>22.5</b>	<b>25.4</b>	<b>29.3</b>
<b>Deficit</b>	<b>-16.0</b>	<b>-5.0</b>	<b>-7.5</b>	<b>-10.9</b>
<b>Debt Held by the Public at the End of the Period</b>	<b>98</b>	<b>109</b>	<b>142</b>	<b>195</b>
<b>Memorandum:</b>				
Social Security				
Revenues <sup>c</sup>	4.9	4.5	4.5	4.4
Outlays <sup>d</sup>	5.3	5.7	6.2	6.3
<b>Contribution to the Federal Deficit<sup>e</sup></b>	<b>-0.4</b>	<b>-1.2</b>	<b>-1.6</b>	<b>-1.9</b>
Medicare				
Revenues <sup>c</sup>	1.5	1.5	1.7	1.7
Outlays <sup>d</sup>	4.2	4.7	6.0	7.1
Offsetting receipts	-0.7	-0.8	-1.1	-1.4
<b>Contribution to the Federal Deficit<sup>e</sup></b>	<b>-2.0</b>	<b>-2.4</b>	<b>-3.2</b>	<b>-4.0</b>
Gross Domestic Product at the End of the Period (Trillions of dollars)	20.6	30.7	43.8	62.0

Source: Congressional Budget Office.

This table satisfies a requirement specified in section 3111 of S. Con. Res. 11, the Concurrent Resolution on the Budget for Fiscal Year 2016.

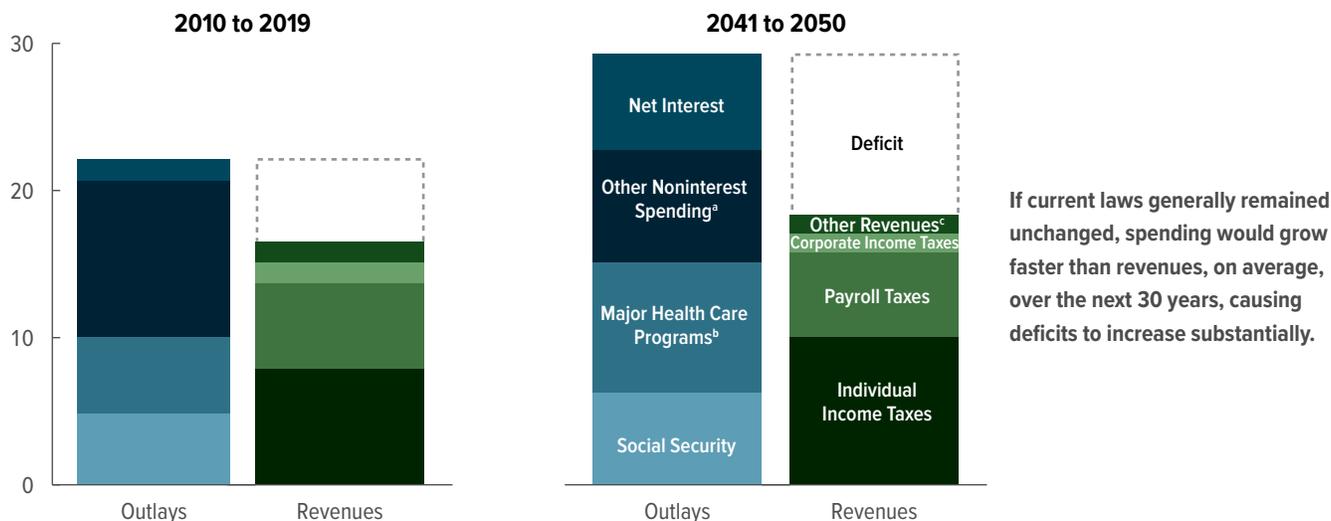
The extended baseline projections, which generally reflect current law, follow CBO's 10-year baseline budget projections and then extend most of the concepts underlying those projections for the rest of the long-term projection period.

- Consists of excise taxes, remittances to the Treasury from the Federal Reserve System, customs duties, estate and gift taxes, and miscellaneous fees and fines.
- Consists of spending for Medicare (net of premiums and other offsetting receipts), Medicaid, and the Children's Health Insurance Program, as well as outlays to subsidize health insurance purchased through the marketplaces established under the Affordable Care Act and related spending.
- Includes all payroll taxes for the program other than those paid by the federal government on behalf of its employees (which are intragovernmental transactions). Also includes income taxes paid on Social Security benefits, which are credited to the trust funds. Excludes interest credited to the trust funds.
- Excludes discretionary outlays related to administration of the program.
- The contribution to the deficit shown here differs from the change in the trust fund balance for the program because it excludes intragovernmental transactions, interest earned on balances, and outlays related to administration of the program.

Figure 2.

**The Federal Budget, on Average, 2010 to 2019 and 2041 to 2050**

Percentage of Gross Domestic Product



If current laws generally remained unchanged, spending would grow faster than revenues, on average, over the next 30 years, causing deficits to increase substantially.

Source: Congressional Budget Office.

- a. Consists of all federal spending other than that for Social Security, the major health care programs, and net interest.
- b. Consists of spending for Medicare (net of premiums and other offsetting receipts), Medicaid, and the Children’s Health Insurance Program, as well as outlays to subsidize health insurance purchased through the marketplaces established under the Affordable Care Act and related spending.
- c. Consists of excise taxes, remittances to the Treasury from the Federal Reserve System, customs duties, estate and gift taxes, and miscellaneous fees and fines.

discretionary spending is assumed to remain roughly constant as a share of GDP throughout the period. Revenues also rise after 2030 (to 18.6 percent of GDP in 2050), although not as quickly as mandatory spending. Driving that increase in revenues is real bracket creep (the process in which an ever-larger proportion of income becomes subject to higher tax rates as income rises faster than inflation).

As a result of those developments, primary deficits are projected to increase to 4.1 percent of GDP in 2040 and 4.5 percent by 2050 (see Figure 4). In CBO’s projections, rising federal debt and higher interest rates combine to nearly quadruple net outlays for interest from 2.2 percent of GDP in 2030 to 8.1 percent in 2050, adding substantially to projected deficits.

**Consequences of High and Rising Federal Debt**

If federal debt as a percentage of GDP continued to rise at the pace that CBO projects it would under current

law, in the long term the economy would be affected in two significant ways:

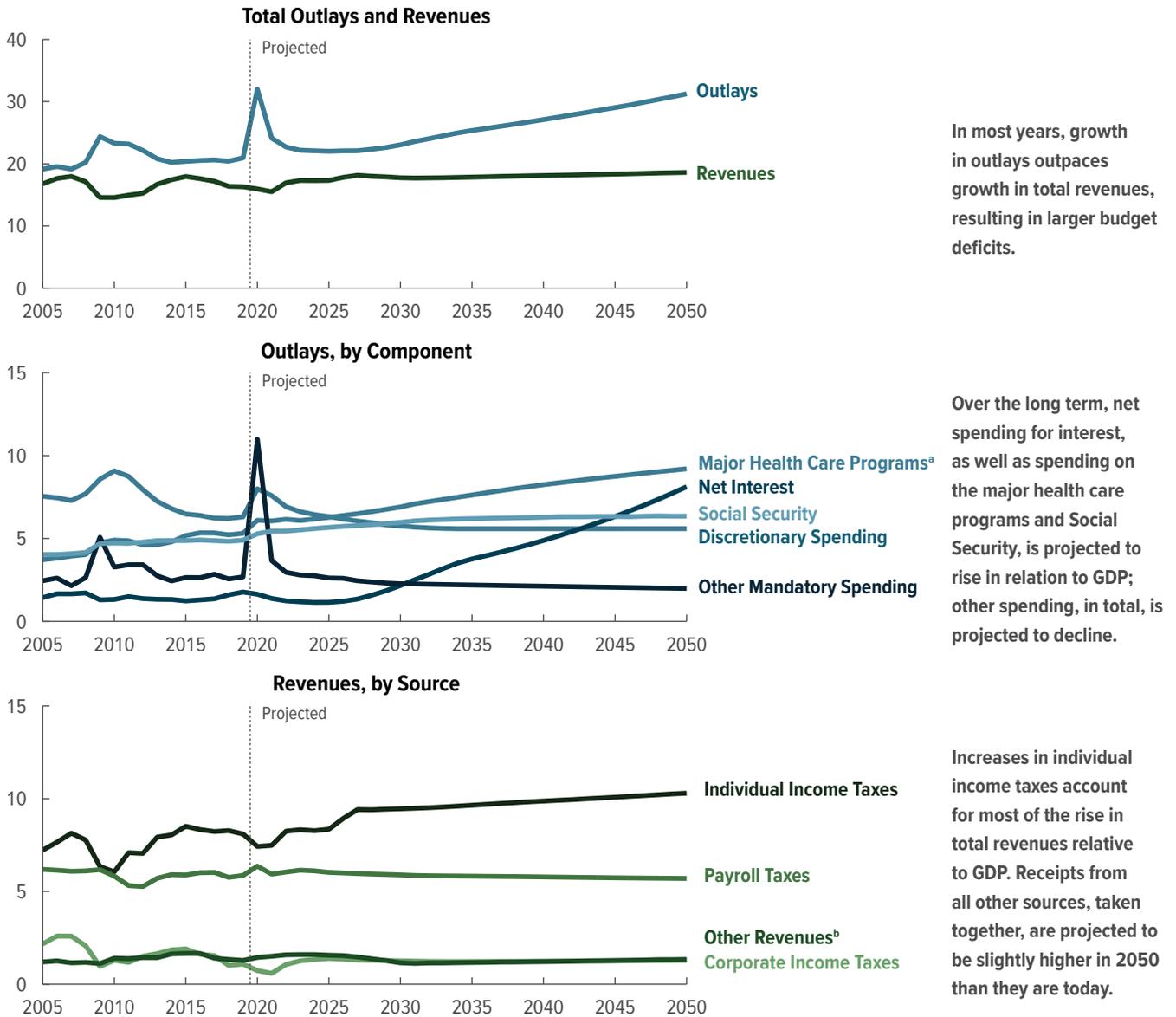
- That debt path would raise borrowing costs, reduce business investment, and slow the growth of economic output over time,<sup>7</sup> and
- Rising interest costs associated with that debt would increase interest payments to foreign holders of U.S. debt and thus reduce U.S. national income.

7. When the federal government borrows in financial markets, it competes with other participants for funds. That competition can crowd out private investment, reducing economic output and income in the long term. By contrast, federal debt held by trust funds and other government accounts represents internal transactions of the government and does not directly affect financial markets. For more discussion, see Congressional Budget Office, *Federal Debt and Interest Costs* (December 2010), [www.cbo.gov/publication/21960](http://www.cbo.gov/publication/21960). Several factors not directly included in budget totals also affect the government’s need to borrow from the public. They include fluctuations in the government’s cash balance as well as the cash flows of the financing accounts used for federal credit programs.

Figure 3.

### CBO's Projections of Outlays and Revenues

Percentage of Gross Domestic Product



Source: Congressional Budget Office.

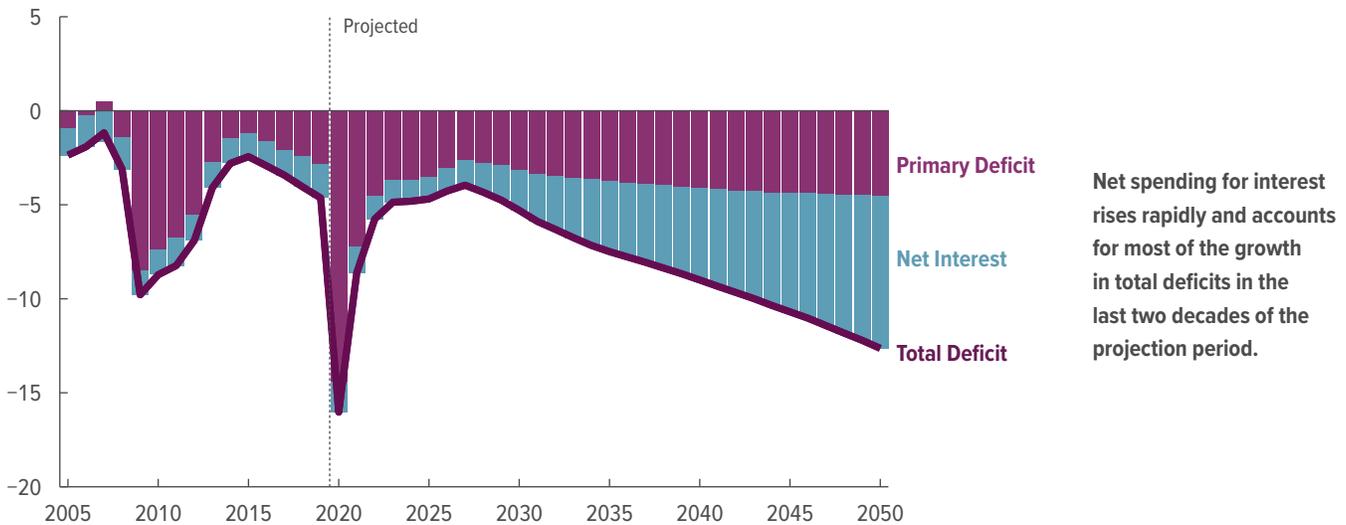
GDP = gross domestic product.

- a. Consists of spending for Medicare (net of premiums and other offsetting receipts), Medicaid, and the Children's Health Insurance Program, as well as outlays to subsidize health insurance purchased through the marketplaces established under the Affordable Care Act and related spending.
- b. Consists of excise taxes, remittances to the Treasury from the Federal Reserve System, customs duties, estate and gift taxes, and miscellaneous fees and fines.

Figure 4.

**Total Deficits, Primary Deficits, and Net Interest**

Percentage of Gross Domestic Product



Source: Congressional Budget Office.

Primary deficits or surpluses exclude net spending for interest.

Persistently rising debt as a percentage of GDP would also pose significant risks to the fiscal and economic outlook, although financial markets currently do not reflect those concerns. In particular, that debt path would have these economic and financial effects:

- It would increase the risk of a fiscal crisis—that is, a situation in which investors lose confidence in the U.S. government’s ability to service and repay its debt, causing interest rates to increase abruptly, inflation to spiral upward, or other disruptions—and
- It would increase the likelihood of less abrupt, but still significant, negative effects, such as expectations of higher rates of inflation and more difficulty financing public and private activity in international markets.

In addition, high and rising debt makes government financing more vulnerable to increases in interest rates because costs to service that debt rise more for a given increase in interest rates when debt is higher than when it is lower. High and rising debt also might cause policymakers to feel restrained from implementing deficit-financed fiscal policy to respond to unforeseen

events or for other purposes, such as to promote economic activity or strengthen national defense.

Not all effects of higher debt and a higher projected path for debt would be negative. Short-term increases in deficits and debt can provide fiscal support to the economy during challenging times, such as the current pandemic. Also, over time a higher debt path would boost interest rates above what they otherwise would be, promoting private saving and giving the Federal Reserve more flexibility in implementing monetary policy. (Higher interest rates would have adverse economic effects, too, as described below.)

Information about the potential effects of high and rising debt better enables policymakers to weigh the consequences of changing fiscal policy sooner rather than later. The benefits of reducing deficits sooner include a smaller accumulated debt and therefore less risk to long-run economic growth and stability. Addressing the debt sooner also means that smaller policy changes would be required to achieve long-term objectives, and it means that households and businesses would have less uncertainty about the effectiveness of policies that lawmakers would adopt.

The risk of reducing deficits sooner is that spending cuts or tax increases that were implemented suddenly might cause economic and financial disruptions because people would have insufficient time to plan for or adjust to the new measures. But the longer policymakers take to implement policies that would reduce federal spending or increase taxes, the more debt would accumulate in the meantime. That additional debt would further slow long-term growth in output and income and ultimately require that even larger policy changes be implemented to reach any given target for debt.<sup>8</sup>

Depending on the path that lawmakers chose, the distributional implications of proposed changes—that is, who would bear the burden of particular cuts in spending or increases in taxes and who would realize the economic benefits—would differ. In general, if policymakers postponed fiscal tightening and if debt as a share of GDP continued to rise, then future generations would bear more of the burden of the changes necessary to stabilize debt. Earlier generations—most notably, people in those generations with higher income and more wealth—would bear less of the burden.

### Effects Incorporated in CBO's Extended Baseline Projections

The high and rising path of federal borrowing in CBO's extended baseline projections would have negative economic consequences over the longer term. Although interest rates remain low for an extended time in CBO's baseline projections, the eventual rise in rates together with the larger amount of debt generates a growing burden of interest payments. Rising interest costs would crowd out the resources available for private investment, diminishing the growth of economic output and income. In addition, rising interest payments would result in increasingly large payments to foreign investors, further dampening domestic income.

**Crowding Out of Private Investment.** In CBO's extended baseline projections, when the government borrows in financial markets, it does so from people and businesses whose savings would otherwise finance private investment, such as factories and computers. Although an increase in government borrowing strengthens people's incentive to save—in part by boosting interest rates—the resulting rise in private saving is not as large as

the increase in government borrowing; national saving, or the amount of domestic resources available for private investment, therefore declines.<sup>9</sup> Private investment falls by less than national saving does in response to larger government deficits, however, because the higher interest rates that are likely to result from increased federal borrowing tend to attract more foreign capital to the United States.

If investment in capital goods declined, workers would, on average, have less capital to use in their jobs. As a result, they would be less productive, they would receive lower compensation, and they would thus be less inclined to work. Those effects would increase over time as federal borrowing grew. If federal borrowing declined, however, those effects would decrease. In CBO's estimation, budgetary changes that began in 2025 and steadily reduced debt to 79 percent of GDP in 2050 (its value in 2019) would, all else being equal, boost economic growth each year by an average of about 0.2 percentage points compared with growth in the agency's extended baseline projections. As a result, GDP would be 5.0 percent higher in 2050 than it is in the extended baseline projections, and GDP per person in 2050 would be about \$4,600 higher (in 2019 dollars).

**Rising Interest Payments.** CBO projects a substantial increase in interest costs over the next 30 years, in part from a projected rise in interest rates. Because debt is already high, even moderate increases in interest rates would lead to significantly higher interest costs. Moreover, federal borrowing is projected to rise significantly, further driving up interest costs. That increase in interest costs would not happen immediately, however, because the lower interest rates associated with the pandemic and the Federal Reserve's policy response to it would offset the effect from financing the rising amount of debt.

8. See Congressional Budget Office, *The Deficit Reductions Necessary to Meet Various Targets for Federal Debt* (August 2018), [www.cbo.gov/publication/54181](http://www.cbo.gov/publication/54181).

9. In CBO's assessment, another reason that an increase in government borrowing strengthens people's incentive to save is that some of them expect policymakers to raise taxes or cut spending in the future to cover the cost of paying interest on the additional federal debt. As a result, some of those people increase their saving to prepare for paying higher taxes or receiving lower benefits. For further discussion of that effect and the estimated effect of federal borrowing on private investment, see Jonathan Huntley, *The Long-Run Effects of Federal Budget Deficits on National Saving and Private Domestic Investment*, Working Paper 2014-02 (Congressional Budget Office, February 2014), [www.cbo.gov/publication/45140](http://www.cbo.gov/publication/45140).

CBO expects interest rates to rise as the economy recovers and then continues to expand, particularly in the latter half of the coming decade. The agency expects the interest rate on 10-year Treasury notes to average 1.3 percent over the 2020–2025 period and 2.8 percent over the 2026–2030 period. Beyond 2030, the interest rate on 10-year Treasury notes is projected to rise steadily, reaching 4.8 percent by 2050. In CBO’s extended baseline projections, net outlays for interest grow from 1.6 percent of GDP in 2020 to 2.2 percent in 2030 and then continue to rise over the next two decades to more than 8 percent by 2050.

Those higher outlays would include an increase in payments to foreign investors (who hold 39 percent of Treasury securities), which reduces net U.S. international income and gross national product (GNP) relative to total domestic economic output (GDP). If, for example, debt was reduced to 79 percent of GDP by 2050, GNP—which, unlike GDP, includes income that U.S. residents earn abroad and excludes income payments to nonresidents—would be 6.7 percent higher than it is in CBO’s extended baseline projections. (Such a reduction in debt would result in a smaller increase in GDP—5.0 percent.) In 2050, GNP per person would be \$6,300 higher (in 2019 dollars) than it is in the extended baseline projections.

A larger amount of debt makes the United States’ fiscal position more vulnerable to an increase in interest rates than it would be if the amount was smaller. In CBO’s projections, the average interest rate on federal debt initially decreases from 2.0 percent in 2020 to 1.1 percent in 2025 and then increases to 4.4 percent by 2050. The change in interest rates accounts for about one-fifth of the projected growth in debt as a share of GDP over the 2020–2050 period. (The cost of financing the primary deficits projected over that period at current interest rates accounts for the remaining four-fifths of that increase.) Therefore, even though rising interest rates have a sizable effect on the fiscal outlook, rising debt levels would substantially boost interest costs even if rates remained unchanged.

CBO’s projections of interest rates reflect several factors. Among them are the historically low interest rates over the past decade, the trajectory of federal debt in the agency’s baseline, and prices in financial markets that indicate expectations of future interest rates. Although factors such as slower growth of the labor force are

projected to put downward pressure on interest rates, CBO expects rates to rise because those factors are more than offset by other, larger factors, such as increases in federal borrowing and slower growth in saving owing to the aging of the population (see Appendix A for details).

Over the past decade, interest rates on Treasury securities have remained relatively low compared with rates in prior decades, despite the historically large amount of federal borrowing. And interest rates have been low recently, even with the increased borrowing to fund fiscal actions in response to the pandemic. Those low rates over the past decade and more recently also partly reflect actions taken by the Federal Reserve.

Recognizing the persistence of the lower interest rates, CBO revised its projections of interest rates downward several times in recent years. For example, the average interest rate on federal debt from 2020 to 2030 is projected to be 1.5 percent, which is 3.5 percentage points lower than what the agency projected for that period in June 2010. Similarly, the average real (inflation-adjusted) interest rate on federal debt is now projected to be -0.5 percent, which is 3.1 percentage points lower than CBO’s 2010 projection. Those downward revisions lower the projected costs of federal borrowing under current law and reduce the estimated changes in fiscal policy that would be necessary to stabilize debt as a share of GDP.

Although persistently low interest rates have dampened the costs of federal borrowing, such low rates can constrain the traditional use of interest rates as the Federal Reserve’s predominant monetary policy tool. If short-term interest rates are very low or even decline to zero, the Federal Reserve is less able to lower interest rates to support economic growth or respond to a negative shock—such as the sudden slowdown in the global economy associated with the pandemic. During and after the financial crisis associated with the 2007–2009 recession, and also in response to the adverse economic effects of the pandemic, the Federal Reserve has employed additional policy tools beyond interest rates. For example, it has set up special credit facilities and instituted large-scale purchases of financial assets to promote liquidity and bolster economic activity. Nonetheless, the effectiveness of such policies on the long-run performance of the economy is unclear. By keeping interest rates higher over time, higher debt would allow for greater potential use of traditional monetary policy tools.

### Greater Risk of a Fiscal Crisis

High and rising federal debt increases the likelihood of a fiscal crisis. Such a crisis can occur as investors' confidence in the U.S. government's fiscal position erodes, undermining the value of Treasury securities and driving up interest rates on federal debt because investors would demand higher yields to purchase those securities. Concerns about the government's fiscal position could lead to a sudden and potentially spiraling increase in people's expectations of inflation, a large drop in the value of the dollar, or a loss of confidence in the government's ability or commitment to repay its debt in full. The risk of a fiscal crisis appears to be low in the short run despite the higher deficits and debt stemming from the pandemic. That risk is also mitigated in the short run by certain characteristics of the U.S. financial system, including independent monetary policy, government debt issued in U.S. dollars, and a central place in the global financial system. Nonetheless, the much higher debt over time would raise the risk of a fiscal crisis in the years ahead.

In a fiscal crisis, dramatic increases in Treasury rates would reduce the market value of outstanding government securities, and the resulting losses incurred by holders of those securities—including mutual funds, pension funds, insurance companies, and banks—could be large enough to cause some financial institutions to fail. A fiscal crisis could thus lead to a financial crisis. Because the United States plays a central role in the international financial system, such a crisis could spread globally.

Policymakers would have several options to respond to a fiscal crisis. Each option would have economic and distributional consequences, though, and choosing among them would involve difficult trade-offs. One policy option would be to dramatically cut noninterest spending or increase taxes, which would have adverse effects on the economy in the short run. Two other options would have more significant effects on currency and financial markets. One option would be to use monetary policy to purchase Treasury securities, which may initially have limited adverse effects but which ultimately would in all likelihood raise inflation (relative to prior inflation expectations), thereby reducing the real cost of financing outstanding debt. Such an action could lead to depreciation of the dollar and undermine its role in international currency markets, which in turn could lead to even higher inflation and declines in real wealth and purchasing power. The other option would

be to restructure the debt (that is, modify the contractual terms of existing obligations) so that repayment was feasible. (Restructuring the debt is generally viewed as less likely because it would undermine investors' confidence in the government's commitment to repay its debt in full.) Coordination of fiscal and monetary policies in times of crisis also could present significant challenges.

The risk of a fiscal crisis depends on factors beyond the amount of federal debt. Ultimately, what matters is the ability to service the debt and the cost of doing so. Among the factors affecting that ability and cost are investors' expectations about the budget and economic outlook, which can change over time, and about domestic and international financial conditions, including interest rates and exchange rates. Furthermore, the relationships between those factors and the risk of a crisis are uncertain and can shift—depending, in part, on the state of the economy. In CBO's assessment, the debt-to-GDP ratio has no set tipping point at which a crisis becomes likely or imminent; nor is there an identifiable set point at which interest costs as a percentage of GDP become unsustainable. Indeed, CBO cannot reliably quantify the probability that a fiscal crisis might occur. Thus, the distribution of possible outcomes that the agency considered in preparing its baseline projections does not include the potential budgetary and economic outcomes of a fiscal crisis.

The risk of a fiscal crisis in the near future is not currently apparent in financial markets, even though the pandemic has increased the federal deficit and caused great uncertainty about the speed and scope of a recovery. However, financial markets do not always fully reflect risks on the horizon and, more importantly, the risk of a fiscal crisis could change suddenly in the wake of subsequent unexpected events. For example, a sudden rise in interest rates could lead investors to become concerned about the government's fiscal position over the long term as their uncertainty grew as to whether the rise was temporary or signaled a long-run trend.

### Risks of Other Disruptions

Even in the absence of an abrupt fiscal crisis, high and rising debt could generate persistent negative effects on the economy beyond those incorporated in CBO's extended baseline projections, including a gradual decline in the value of Treasury securities and other domestic assets. High and rising debt could lead to moderate but ongoing increases in inflation expectations. Increases in federal borrowing could also lead to an

erosion of confidence in the U.S. dollar as an international reserve currency. Among other effects, such developments would make it more difficult to finance public and private activity. Moreover, the increased dependence on foreign investors—who would hold larger and larger amounts of that high and rising debt—could pose other challenges, such as making U.S. financial markets more vulnerable to a change in the valuation of U.S. assets by participants in global markets.

The projected amount of debt increases the risk that interest costs would be substantially greater than projected—even without a fiscal crisis—if interest rates were higher than those underlying CBO’s extended baseline projections. For example, if the average borrowing rate was 1 percentage point higher every year than the rate underlying the agency’s extended baseline projections, but all other aspects of the economy were unaffected, then the government’s net interest costs would amount to about 15 percent of GDP 30 years from now, which is 7 percentage points more than in CBO’s extended baseline projections. That amount is equal to about four-fifths of federal revenues projected for 2050. Moreover, under those circumstances, federal debt would be over 260 percent of GDP, which is about 70 percentage points higher than in the extended baseline projections. If interest rates jumped, investors could become concerned about the government’s fiscal position over the long term as they tried to determine whether the uptick in rates was temporary or signaled a long-run trend. Alternatively, a lower borrowing rate would result in smaller interest costs than those in CBO’s extended baseline projections.

High and rising debt (and the large deficits that result) might also constrain policymakers’ choices about fiscal policy going forward. As the federal government increased its borrowing, ever-larger cuts in primary deficits would be required to achieve particular targets for deficits or debt. As a result, policymakers could feel restrained from using deficit-financed fiscal policy to respond to unforeseen events or for other purposes (to promote economic activity or further other goals, for example), a situation that might not occur if debt and deficits were lower (or the increase was smaller). High debt could also undermine national security if it compromised the international geopolitical role of the United States or if policymakers felt constrained from increasing national security spending to prepare for or resolve an international crisis.

Risks also arise from the interaction of fiscal and monetary policy in response to higher debt. For example, the Federal Reserve’s large-scale purchases of Treasury securities and other financial assets in response to the pandemic pose risks to the outlook for interest rates. CBO expects the Federal Reserve’s holdings of Treasury securities, measured as a share of GDP, to begin declining after 2024, which would put modest upward pressure on long-term interest rates. There is some risk, however, that participants in financial markets could react adversely to the Federal Reserve’s efforts to taper its holdings of such assets by sharply reducing their demand for Treasury securities, which would cause long-term interest rates to rise rapidly. There is also a possibility that concern about such an adverse reaction by financial market participants could cause the Federal Reserve to delay reducing its holdings of Treasury securities, which would result in lower long-term interest rates for longer than CBO projects in its baseline.

### **The Size and Timing of Policy Changes Needed to Meet Various Targets for Debt**

CBO estimated the size of changes in spending or revenues (or both) that would be needed if lawmakers wanted to achieve some specific targets for federal debt held by the public. The agency also assessed the extent to which the size of policy adjustments would change if deficit reductions occurred later, and it examined how waiting to resolve the long-term fiscal imbalance would affect the economy and different generations of the U.S. population.

#### **The Size of Policy Changes**

If lawmakers wanted debt in 2050 to remain at roughly its level at the end of this fiscal year (about 100 percent of GDP), they could cut noninterest spending or raise revenues (or do both) in each year beginning in 2025 by amounts totaling 2.9 percent of GDP (see Table 2). In 2025, 2.9 percent of GDP would be about \$730 billion, or \$2,200 per person. If such an adjustment was made in 2025 and each year thereafter, the budget would show a primary deficit of 1.9 percent of GDP in 2030 and 4.7 percent of GDP by 2050. If such changes came entirely from either revenues or spending, they would amount to a 17 percent increase in revenues or a 14 percent cut in noninterest spending, on average (relative to amounts in CBO’s extended baseline projections). After 2050, growth in spending relative to the size of the economy would probably continue to outpace growth in revenues, and deficits would rise further.

Table 2.

### The Size of Policy Changes Needed to Make Federal Debt Meet Two Possible Goals in 2050

	2050 Debt Target	
	79 Percent of GDP	100 Percent of GDP
Deficit Reduction Needed		
Annually, 2025 to 2050 (Percentage of GDP)	3.6	2.9
Total reduction in 2025 (Billions of dollars)	900	730
Per person reduction in 2025 (Dollars)	2,700	2,200

Source: Congressional Budget Office.

In this table, the indicated sizes of policy changes are relative to CBO's extended baseline projections. Those projections, which generally reflect current law, follow CBO's 10-year baseline budget projections and then extend most of the concepts underlying those projections for the rest of the long-term projection period. The projected effects of the policy changes on debt include the direct effects of the policy changes and the feedback to the federal budget from faster economic growth. The effects on growth and the feedback to the federal budget reflect the positive economic effects of lowering the debt but do not reflect any assumptions about the specific details of the policy changes.

GDP = gross domestic product.

Increases in revenues or cuts in noninterest spending would need to be larger than 2.9 percent of GDP to reduce debt to its 2019 level (79 percent of GDP) by 2050. To achieve that goal, lawmakers could increase revenues or cut noninterest spending (in relation to amounts under current law) or adopt some combination of those two actions beginning in 2025 by amounts totaling 3.6 percent of GDP each year. In 2025, 3.6 percent of GDP would be about \$900 billion, or \$2,700 per person. If such changes were made solely by increasing revenues or cutting noninterest spending, total revenues would need to be about 20 percent higher, or noninterest spending would need to be about 17 percent lower, on average, in each year over the 2025–2050 period.

In those examples, the projected effects on debt include both the direct effects of the policy changes and the feedback to the federal budget that would result from faster economic growth. In general, reducing the federal debt increases the resources available for private investment in capital goods and services, which boosts the stock of private capital and economic output. The policy changes examined here are illustrative, however, and the results

do not reflect any particular assumptions about specific changes. Any policy change could alter productivity growth and people's incentives to work and save, which would in turn affect overall economic output and feed back to the federal budget.

### The Timing of Policy Changes

The size of the policy changes needed to achieve a particular goal for federal debt would depend, in part, on how quickly that goal was expected to be reached. Regardless of the chosen goal for federal debt, lawmakers would face trade-offs in deciding how quickly to implement policies designed to stabilize or reduce debt as a percentage of GDP.

CBO estimated the extent to which the size of policy adjustments would change if deficit reduction was delayed until 2030 or 2035. (The agency did not make any assumptions about the specific policy changes that might be used to reduce the deficit.) If lawmakers sought to reduce debt as a share of GDP to 79 percent in 2050 and if the necessary policy changes did not take effect until 2030, the annual reduction in the primary deficit would need to amount to 4.4 percent of GDP rather than the 3.6 percent that would accomplish the same goal if the changes were made starting in 2025 (see Figure 5). If lawmakers chose to wait another five years to implement the policies (having them take effect in 2035), even larger changes would be necessary; in that case, the required annual reduction in the primary deficit would amount to 5.9 percent of GDP.

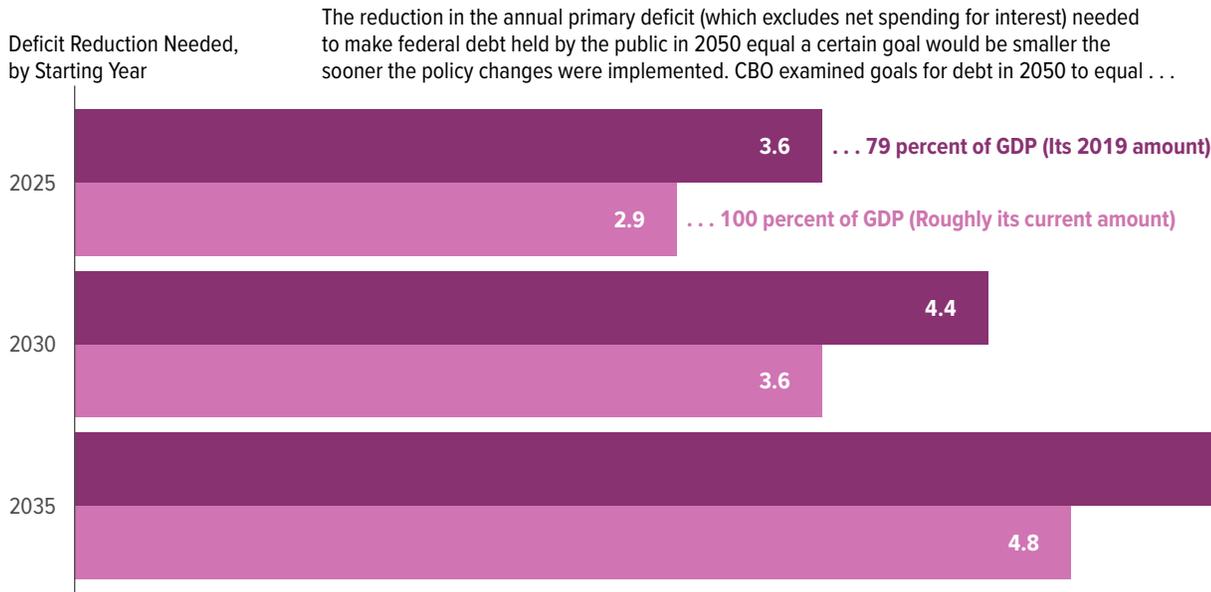
**Effects on the Economy.** Over the first few years following their adoption, such policy changes would dampen overall demand for goods and services, thus decreasing output and employment below amounts projected under current law. (CBO did not analyze short-term economic outcomes under those scenarios.) That dampening effect would be temporary, however. Lower deficits and debt would eventually reduce prices and interest rates, which would increase the resources available for private investment, household consumption, and net exports.

If policymakers decided to reduce the deficit sooner rather than later, the benefits would include a smaller accumulated debt, smaller policy changes required to achieve long-term outcomes, and less uncertainty about the expected changes.

Figure 5.

### How Timing Affects the Size of Policy Changes Needed to Make Federal Debt Meet Two Possible Goals in 2050

Percentage of Gross Domestic Product



Source: Congressional Budget Office.

By contrast, if policymakers waited longer to reduce federal spending or increase taxes, more debt would accumulate, which would slow the growth of output and income. Delaying implementation would thus mean that reaching any chosen target for debt would require larger changes. Nonetheless, if policymakers waited longer to enact deficit-reduction policies, the economy probably would be affected less over the short term than it would be if changes were made immediately.

Even if lawmakers waited to implement policy changes to reduce deficits in the long term, deciding about those changes sooner would offer two main advantages. First, people would have more time to prepare by adjusting the number of hours they work, the age at which they plan to retire, and the amount they choose to save. Second, policy changes that reduced the debt over the long term would hold down longer-term interest rates and could lessen uncertainty—thus enhancing businesses’ and consumers’ confidence. Those factors would boost output and employment in the near term.

**Effects on Different Generations.** Faster or slower implementation of policies to reduce budget deficits would tend to impose different burdens on different generations. Reducing deficits sooner would probably impose a greater burden on older workers and retirees but a lesser burden on younger workers and future generations. Reducing deficits later would impose a smaller burden on older workers and retirees but a greater burden on younger workers and future generations. However, the additional burden on people in younger generations resulting from delaying policy changes would be relatively small compared with their lifetime earnings potential because, on average, people in future generations are expected to have much higher income than those in current generations.

CBO studied the effects on the average real disposable income per person in various generations from waiting to resolve the long-term fiscal imbalance. In particular, the agency compared economic outcomes under two types of policies. One would stabilize the debt-to-GDP ratio starting in a particular year, and the other would wait 10 years to do so. For policies such as across-the-board

benefit cuts or tax rate increases for all adults, that analysis suggests that the average income of people in generations born after the earlier implementation date would be lower under the policy with a 10-year delay.<sup>10</sup> In contrast, people born more than 25 years before the earlier implementation date would have a higher average income if action was delayed—mainly because they would partly or entirely avoid the policy changes needed to stabilize the debt. Generations born between those two groups could either gain or lose from delayed action, depending on the specific details of the policy changes.<sup>11</sup>

CBO's analysis indicates that delaying policy changes would reduce the well-being of younger generations (compared with their well-being if policy changes occurred earlier). Moreover, the farther in the future that a policy change occurred, the more the well-being of older generations would be improved and that of younger generations would be worsened.

### Demographic and Economic Trends Underlying CBO's Long-Term Projections

CBO's projections of demographic and economic trends are key determinants of the long-term budget outlook. (For a description of those projections, see Appendix A.) Through 2030, the economic and demographic projections presented in this report are the same as those that CBO published in July.<sup>12</sup> Those projections reflect the demographic and economic effects of the pandemic and associated social distancing measures, and they include the agency's estimates of the economic effects of enacted

legislation. In CBO's assessment, that legislation will partially offset the deterioration in economic conditions brought about by the pandemic.<sup>13</sup> For years beyond 2030, CBO projects conditions on the basis of its assessment of long-term trends. The agency uses a model with four components to integrate demographic and economic changes into its long-term budget projections.<sup>14</sup>

- A demographic model is used to project the size of the population by age and sex.
- A microsimulation model is used to project annual changes in demographic characteristics and economic outcomes for a representative sample of the population.
- A long-term budget model is used to project federal outlays, revenues, deficits, and debt beyond CBO's standard 10-year budget period.
- A model of economic growth is used to simulate how demographic changes, economic factors, and fiscal policy affect the U.S. economy and, in turn, the federal budget.

Those four components interact in various ways. For example, the economic projections reflect how increases in spending and revenues in the extended baseline projections would affect the economy. In turn, the budgetary outcomes in the extended baseline projections reflect those economic effects.

### Demographic Projections

The size and age profile of the U.S. population affects the federal budget and the nation's economy. For example, the age distribution of the population influences the size of the labor force and the number of beneficiaries of Social Security and other federal programs. In CBO's projections, the U.S. population increases from 334 million at the beginning of 2020 to 378 million in 2050, expanding by 0.4 percent per year, on average. That rate is slower than the average annual rate of growth over the past 50 years (0.9 percent). The share of the population

10. Those results are preliminary conclusions from an update to work that CBO published in 2010. See Congressional Budget Office, *Economic Impacts of Waiting to Resolve the Long-Term Budget Imbalance* (December 2010), [www.cbo.gov/publication/21959](http://www.cbo.gov/publication/21959). That analysis was based on a projection of slower growth in debt than CBO now projects, so the estimated effects of a similar policy today would be close, but not identical, to the effects estimated in that analysis. For a different approach to analyzing the costs of debt reduction for different generations, see Shinichi Nishiyama and Felix Reichling, *The Costs to Different Generations of Policies That Close the Fiscal Gap*, Working Paper 2015-10 (Congressional Budget Office, December 2015), [www.cbo.gov/publication/51097](http://www.cbo.gov/publication/51097).

11. Those conclusions do not incorporate the negative effects that would arise from a fiscal crisis (if one occurred) or the effects that might arise from the government's reduced flexibility to respond to those challenges.

12. See Congressional Budget Office, *An Update to the Economic Outlook: 2020 to 2030* (July 2020), [www.cbo.gov/publication/56442](http://www.cbo.gov/publication/56442).

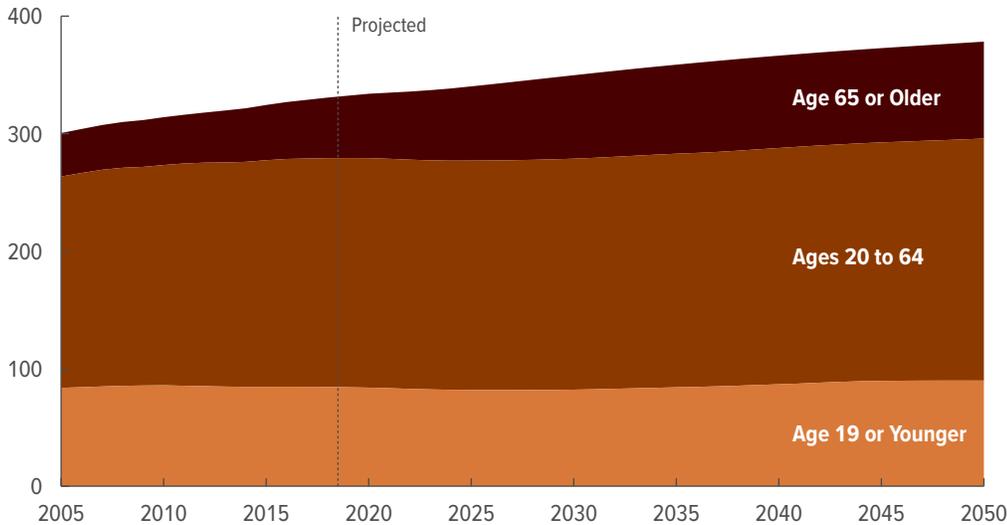
13. See Congressional Budget Office, *The Effects of Pandemic-Related Legislation on Output* (September 2020), [www.cbo.gov/publication/56537](http://www.cbo.gov/publication/56537).

14. See Congressional Budget Office, *An Overview of CBOLT: The Congressional Budget Office Long-Term Model* (April 2018), [www.cbo.gov/publication/53667](http://www.cbo.gov/publication/53667).

Figure 6.

**Population, by Age Group**

Millions of People



CBO projects that the population will become older, on average, throughout the projection period as the share of the population age 65 or older continues to grow.

Source: Congressional Budget Office.

Actual data are shown through calendar year 2018, the most recent year for which such data are available.

that is age 65 or older also expands over the coming decades, continuing a long-standing historical trend. By 2050, 22 percent of the population will be 65 or older, whereas today that share is 16 percent (see Figure 6). To estimate the growth of the U.S. population, CBO projects rates of fertility, net immigration, and mortality.

**Fertility.** In CBO’s projections, the total fertility rate—representing the average number of children that a woman has in her lifetime—decreases from 1.7 children per woman in 2020 to 1.6 children per woman in 2021 in response to the pandemic. The rate gradually increases to 1.9 children per woman by 2028 and remains at that level through 2050. That rate is below the replacement-level fertility rate of 2.1 children per woman that generally ensures that the population will remain steady, with no migration.

In general, the total fertility rate falls during recessions and rebounds during recoveries. Instead of rebounding after the 2007–2009 recession, however, the fertility rate fell from 2.1 children per woman in 2007 to 1.7 children per woman in 2019 (the most recent year for which

data are available).<sup>15</sup> That decline in fertility rates, which was largely attributable to fewer births among women younger than age 24, results in slower growth of the population in the future and reduces CBO’s projections of economic growth in the second decade of the projection period (2031 to 2040).

**Immigration.** Because fertility is projected to remain below its replacement-level rate, the projected growth of the U.S. population increasingly stems from net immigration flows. In 2018, net immigration accounted for approximately 48 percent of overall population growth. In 2050, by contrast, projected net immigration accounts for nearly all population growth. CBO’s projection of net immigration in the near term includes the effects of changing economic conditions, heightened travel restrictions, and reduced visa processing capabilities associated with the pandemic. In CBO’s projections, the rate of net annual immigration averages 2.8 immigrants per 1,000 people in the U.S. population over the next 30 years, rising from 1.6 immigrants per 1,000 people in 2020 to 2.9 immigrants per 1,000 people by 2050.

15. See Brady E. Hamilton and others, *Births: Provisional Data for 2019*, Vital Statistics Rapid Release Report 8 (National Center for Health Statistics, May 2020), [www.cdc.gov/nchs/data/vsrr/vsrr-8-508.pdf](http://www.cdc.gov/nchs/data/vsrr/vsrr-8-508.pdf) (372 KB).

CBO projects net flows for three broad categories of immigrants: legal permanent residents, foreign-born people without legal status, and legal temporary residents.<sup>16</sup> Net flows of legal permanent residents constitute the largest category, averaging 790,000 people per year in the first decade of the projection period (2020 to 2030), rising to 870,000 people per year in the third decade (2041 to 2050). The other two categories are much smaller: Net flows of foreign-born people without legal status average 10,000 people per year in the first decade, rising to 130,000 people per year in the third decade. The net flow of legal temporary residents averages 60,000 people per year in the first decade, rising to 80,000 people per year in the third decade. Between 2021 and 2040, immigration is projected to increase as the effects of the pandemic ease and economic conditions are once again an important predictor of net flows of foreign-born people without legal status.

**Mortality.** Mortality rates are projected to decline (that is, life expectancy is projected to increase) over the next 30 years, on average. That decline in mortality rates is projected to occur even though the number of deaths per 1,000 people in the U.S. population has increased in recent years, because CBO expects the rate of mortality improvement to return to its longer-run trend.<sup>17</sup> In the near term, the agency's projections of mortality incorporate more deaths among people age 55 or older to reflect the effects of the pandemic. Those additional deaths include fatalities directly attributable to the coronavirus as well as increased fatalities attributable to heart disease, diabetes, and pneumonia and other respiratory illnesses; they are partially offset by decreases in fatalities associated with a reduction in accidental deaths. Life expectancy at birth is projected to increase from an average of

79.0 years in the first decade of the projection period to an average of 81.6 years in the third decade. Similarly, life expectancy at age 65 is projected to increase from an average of 19.7 years in the first decade to an average of 21.3 years in the third decade of the period.<sup>18</sup>

### Economic Projections

The performance of the U.S. economy in coming decades will affect the federal government's spending, revenues, and accumulation of debt. CBO makes its long-run economic projections by assessing trends in key economic variables, such as the size of the labor force, productivity growth, and interest rates. The agency also considers the ways in which factors like climate change and fiscal policy influence economic activity.

In CBO's extended baseline projections, growth in potential (or maximum sustainable) GDP over the next 30 years is slower than it has been over the past 50 years. From 2020 to 2050, real potential GDP increases at an average rate of 1.6 percent per year, whereas it grew at an average annual rate of 2.8 percent from 1969 to 2019.

**Size of the Labor Force.** That slower growth in potential GDP is attributable to several factors—most notably, slower growth of the potential labor force (the labor force adjusted for fluctuations in the business cycle). In CBO's projections, the potential labor force grows by 0.3 percent per year, on average, through 2050; over the past 50 years, its average annual rate of growth was 1.4 percent (see Figure 7). Slowing population growth and the aging of the population account for most of that slowdown.

**Productivity Growth.** The agency projects that real GDP per hour worked, a measure of economywide productivity, will grow at an average annual rate of just under 1.3 percent over the next 30 years. That rate is nearly 0.3 percentage points slower than the average annual rate of growth over the past 30 years. A separate measure of productivity, potential labor force productivity (that is, potential output per member of the potential labor force) is also expected to grow at an annual average rate of 1.3 percent over the 2020–2050 period (see Figure 7).

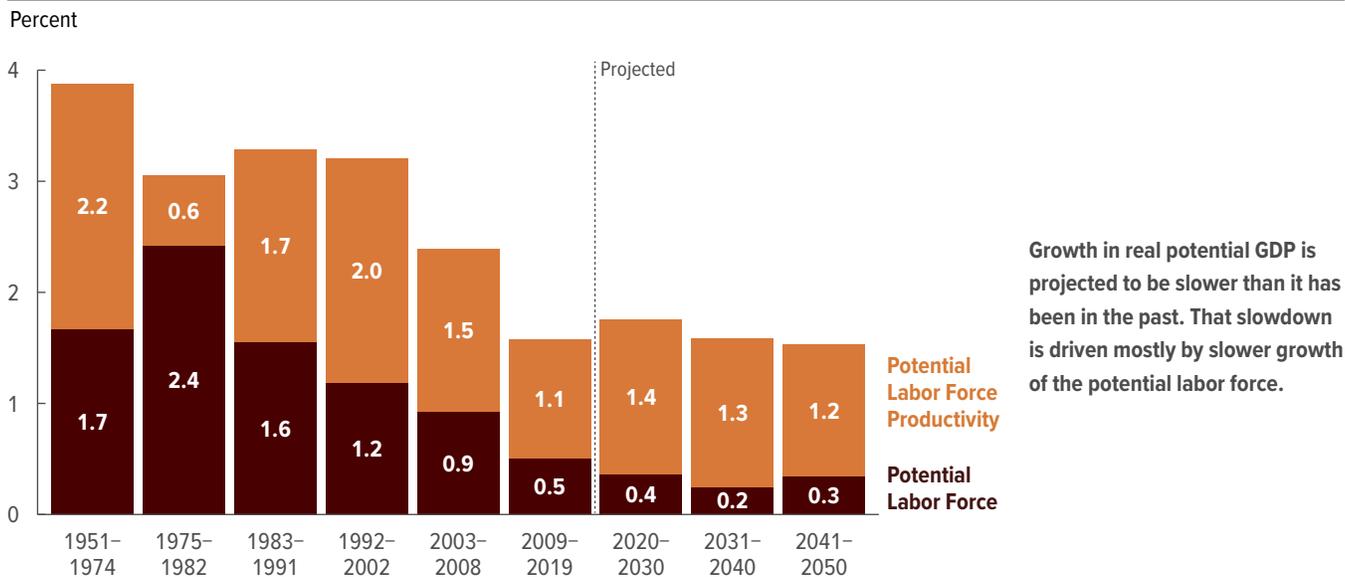
16. CBO uses the term “foreign-born people without legal status” to refer to foreign-born people who entered the United States illegally or who entered legally in a temporary status and then remained after that legal status expired; both categories of people are not authorized to work in the United States. Foreign-born people without legal status also include beneficiaries under Temporary Protected Status, beneficiaries under policies whereby the executive branch does not seek their immediate deportation (such as Deferred Action for Childhood Arrivals), and people who are paroled and allowed into the country while awaiting deportation proceedings in immigration courts. Many of those people are authorized to work in the United States.

17. See Jiaquan Xu and others, *Mortality in the United States, 2018*, Data Brief 355 (National Center for Health Statistics, January 2020), [www.cdc.gov/nchs/data/databriefs/db355-h.pdf](http://www.cdc.gov/nchs/data/databriefs/db355-h.pdf) (424 KB).

18. That measure is for period life expectancy, which is the amount of time that a person in a given year would expect to survive beyond his or her current age on the basis of that year's mortality rates for people of various ages.

Figure 7.

### Average Annual Growth of Real Potential GDP



Growth in real potential GDP is projected to be slower than it has been in the past. That slowdown is driven mostly by slower growth of the potential labor force.

Source: Congressional Budget Office.

Real potential GDP is the maximum sustainable output of the economy, adjusted to remove the effects of inflation. The two contributing factors to real potential GDP growth are growth in the potential labor force and growth in potential labor force productivity. The potential labor force is the labor force (that is, the number of people in the civilian noninstitutionalized population who are age 16 or older and who are either working or actively seeking work), adjusted to remove the effects of fluctuations in the business cycle. Growth in potential labor force productivity is the growth of the ratio of real potential GDP to the potential labor force, or the growth in real potential GDP that is not explained by growth in the potential labor force.

GDP = gross domestic product.

Growth of GDP per hour worked is determined by two factors. One factor is the accumulation of capital, such as structures and equipment, intellectual property products (such as computer software), and residential housing. The second factor is the growth of total factor productivity (TFP)—real output per unit of combined labor and capital in the various sectors of the economy. Most TFP growth occurs in the nonfarm business sector, which accounts for about three-quarters of economic activity. Several trends and developments underlie CBO’s projection of TFP, including trends in labor quality (workers’ educational attainment and experience), federal investment, and climate change. Although many of those trends are unaffected by the pandemic, some may be affected in ways that could have persistent effects on output. For instance, a significant loss of effective schooling among today’s children would have lasting negative effects.

Both factors are projected to grow more slowly over the coming 30 years than they did in the preceding 30 years. Capital accumulation is projected to grow particularly slowly, in part because increased federal borrowing is projected to crowd out private investment. In contrast, growth of nonfarm business TFP is projected to accelerate from its historically slow rate of recent years and grow at an average rate only slightly slower than the average of the past 30 years.

**Interest Rates.** CBO expects interest rates to be lower in 2020 than they were in 2019, and short-term interest rates to remain low through 2025 before gradually rising over the remainder of the decade. In CBO’s projections, rates continue to rise from 2030 to 2050 but still remain lower than they have been historically. Notably, the interest rate on 10-year Treasury notes rises from an average of 0.7 percent in mid-2020 to 3.2 percent in 2030 and 4.8 percent in 2050—one percentage point below the 5.8 percent average recorded over the 1990–2007 period.

Several factors, including slower growth of the labor force, slower productivity growth, and lower inflation than in the past, are expected to keep interest rates below their historical levels; in CBO's projections, the effects of those three factors and others outweigh the effects of rising federal debt and other factors that tend to push interest rates above their historical levels.

The average interest rate on all federal debt held by the public tends to be lower than the rate on 10-year Treasury notes. (Interest rates are generally lower on shorter-term debt than on longer-term debt because shorter-term debt is less risky, and the average term to maturity for federal debt has been less than 10 years since the 1950s.) On the basis of projections of interest rate spreads, CBO expects the average interest rate on federal debt to be 0.3 percentage points lower than the interest rate on 10-year Treasury notes after 2035. As a result, in CBO's projections, the average interest rate on federal debt rises from 2.1 percent in 2030 to 4.4 percent by 2050.

**Effects of Climate Change.** Climate change is expected to affect GDP in a variety of ways, some of which will increase output and some of which will reduce output, though CBO expects that climate change will, on net, reduce GDP. For instance, longer growing seasons in northern states are expected to increase agricultural output, but increased instances of extreme heat in other regions are expected to reduce agricultural output. Stronger hurricanes and bigger storm surges caused by rising sea levels are expected to decrease economic output, on net, by reducing the nation's capital stock.

CBO projects that, on net, climate change will reduce the growth rate of real GDP from 2020 to 2050 by an average of 0.03 percentage points compared with what the growth rate of real GDP would have been if the climatic conditions remained the same through 2050 as they were at the end of the 20th century. That growth rate reduction, accumulated over 30 years, lowers CBO's projected level of real GDP in 2050 by 1.0 percent.

CBO's projection is in the middle of a wide range of possible outcomes, reflecting a variety of economic and scientific uncertainties. CBO also expects climate change

to have various effects on the United States that are not directly reflected in economic output (see Box 1).<sup>19</sup>

**Effects of Fiscal Policy.** CBO's economic projections incorporate the macroeconomic effects of projected federal deficits as well as changes in federal tax and spending policies under current law. In particular, the agency projects that borrowing by the federal government would crowd out some private investment in capital over time. Over the next few years, that crowding out of private investment would be much smaller than it would be otherwise because economic conditions brought about by the pandemic will cause short-term interest rates to remain near zero, CBO projects. As the economy expands and interest rates rise, the crowding out of private investment would increase, causing output to be lower in the long term than it would be otherwise, especially in the last two decades of the projection period. Less private investment and a smaller capital stock would also make workers less productive, leading to lower wages, which would reduce people's incentive to work and thus lead to a smaller supply of labor.

The agency also incorporates the economic effects of higher marginal tax rates in its extended baseline projections. Under current law, marginal tax rates on individual income are scheduled to rise at the end of 2025. Moreover, as more income is pushed into higher tax brackets over time, labor and capital income face higher effective tax rates.<sup>20</sup> Higher marginal tax rates on labor income would reduce people's after-tax wages and thus lessen their incentive to work. Similarly, an increase in the marginal tax rate on capital income would reduce people's incentives to save and invest, resulting in a lower stock of productive capital, which reduces labor productivity and puts downward pressure on wages. All told, less private investment and a smaller labor supply would decrease economic output and income.

19. For additional information on the methodology CBO used to estimate the effect of climate change on GDP, see Evan Herrstadt and Terry Dinan, *CBO's Projection of the Effect of Climate Change on U.S. Economic Output*, Working Paper 2020-06 (Congressional Budget Office, September 2020), [www.cbo.gov/publication/56505](http://www.cbo.gov/publication/56505).

20. See Congressional Budget Office, "How Income Growth Affects Tax Revenues in CBO's Long-Term Budget Projections" (presentation, June 2019), [www.cbo.gov/publication/55368](http://www.cbo.gov/publication/55368).

## Projected Spending Through 2050

Spending by the government is projected to represent a larger percentage of GDP in coming years than it has, on average, over the past 50 years. Moreover, CBO projects that growth in spending for Social Security, the major health care programs, and interest would reshape the spending patterns of the U.S. government by 2050 (see Figure 8 on page 26). Net spending for interest would account for a much greater portion of total federal spending in 2050 than it did in 2019, and spending on Social Security and the major health care programs would account for a much larger share of all federal noninterest spending. Discretionary spending, however, would account for a smaller share of all federal noninterest spending in 2050 than it did in 2019.

Excluding net spending on interest, federal outlays averaged about 18 percent of GDP from 1970 to 2019. Under current law, noninterest outlays are projected to reach 30.4 percent of GDP in 2020 (because of increased spending in response to the pandemic and decreased nominal GDP from the previous year), up from 19.2 percent in 2019. In CBO's baseline projections, noninterest spending starts to decline as a share of GDP in 2021, as the effects of legislation related to the pandemic wane, and reaches 20.9 percent in 2030.

Relative to GDP, mandatory spending is projected to fall from 2021 to 2024 and then rise in most years through 2030. (Mandatory spending includes spending on Social Security and the major health care programs—mainly Medicare and Medicaid—as well as outlays for many smaller programs.) Outlays for discretionary programs decrease in relation to GDP from 2021 to 2030 because of caps on 2021 funding and because the rate of inflation is projected to be lower than the rate of growth of nominal GDP. (Inflation rates are used to project future spending under the rules that govern the construction of CBO's baseline projections.)

After 2030, under the assumptions that govern the extended baseline, noninterest spending relative to the size of the economy continues to rise, reaching 23.1 percent of GDP by 2050. (For a summary of the assumptions about spending and revenues that underlie CBO's extended baseline, see Table 3 on page 27.) The two biggest mandatory spending programs, Social Security and Medicare, account for most of the increase in noninterest outlays, whereas discretionary spending is assumed to remain constant as a share of GDP through 2050.

Under current law, net interest costs are projected to decline in the first few years of the projection period, as the average interest rates on debt held by the public remain low and the effects of those lower rates initially more than offset the effects of the accumulating debt. After several years, though, rising average interest rates on federal debt, along with projected increases in the amount of that debt, cause net interest costs to increase. By 2050, those costs are projected to equal 8 percent of GDP (nearly quadruple their value in 2030), boosting total federal spending to 31 percent of GDP in that year. Spending has exceeded that level only once, for a three-year period during World War II. In those years, when defense spending increased sharply, total federal spending topped 40 percent of GDP.

## Spending for Social Security and the Major Health Care Programs

Mandatory programs have accounted for a growing share of the federal government's noninterest spending over the past few decades. Most of that growth has occurred because the number of people age 65 or older—the group that receives most of the benefits provided by Social Security and Medicare—has been growing significantly. In CBO's extended baseline, the aging of the U.S. population continues to drive up outlays for Social Security and Medicare. Outlays for Medicare also climb because, in CBO's estimation, health care costs per person will continue to rise. By 2050, CBO projects, federal spending for Social Security, Medicare, and Medicaid (the federal health care program for people with limited income and resources) for people age 65 or older would account for about half of all federal noninterest spending, rising from about one-third in 2020.

**Social Security.** Social Security is the largest single program in the federal budget. Its two components pay benefits to about 65 million people in all. The larger of the two, Old-Age and Survivors Insurance (OASI), pays benefits to retired workers, their eligible dependents, and some survivors of deceased workers. The smaller program, Disability Insurance (DI), makes payments to disabled workers and their dependents until those workers are old enough to claim full retirement benefits under OASI.

In CBO's projections, spending for Social Security increases noticeably as a share of the economy, continuing the trend of the past five decades. The number of Social Security beneficiaries rises from about 65 million

## Box 1.

**Interpreting CBO's Projection of the Effect of Climate Change on Economic Output**

The Congressional Budget Office takes into account many factors in producing its long-term economic forecasts, including the effect of climate change on growth in real (inflation-adjusted) U.S. gross domestic product (GDP). Climate change is expected to have both positive and negative effects on the U.S. economy. CBO projects that, on net, climate change will reduce the growth rate of real GDP from 2020 to 2050 by an average of 0.03 percentage points compared with what the growth rate of real GDP would have been if the climatic conditions remained the same through 2050 as they were at the end of the 20th century. That reduction in the growth rate, accumulated over 30 years, lowers CBO's projected level of real GDP in 2050 by 1.0 percent.

This box provides information on the effects of climate change on GDP and on aspects of people's well-being not reflected in GDP. It also examines the uncertainty associated with CBO's projection and the method that the agency uses in this projection compared with the method it used in previous years.<sup>1</sup>

**How Climate Change Affects GDP**

Climate change affects GDP both directly and indirectly over various time periods. Some aspects of climate change would affect GDP in a relatively direct manner and would occur immediately. For example, if a farmer's crop yield was lower because of extreme heat, that farmer's contribution to GDP would also be smaller in that year. But if a farmer's yield was higher because a cold-weather region experienced a longer-than-usual growing season, that farmer's contribution to GDP would be larger. Similarly, if extreme heat made construction workers less productive and reduced the number of jobs their crew could complete in a season, their contribution to GDP would be smaller in that year. But if a reduction in extreme cold allowed that crew to work a longer construction season, their contribution to GDP would be larger in that year.

Other aspects of climate change would have more complicated and indirect effects on GDP that might arise over an extended period. For example, suppose that increases in hurricane damage induced by climate change resulted in the destruction of \$50 million worth of factory equipment.

Because the value of that stock of equipment is not counted in the current production of U.S. goods and services, that \$50 million worth of damage would not count as a reduction in GDP. Instead, the \$50 million of damage would affect future GDP in three ways.

First, the factory would not be able to produce at its prehurricane level, and GDP would be reduced to the extent that other U.S. factories could not make up that missing output. Second, if the owner of the factory replaced the \$50 million of destroyed equipment, that investment would be included in GDP in the year the new equipment was purchased. Third, the economy's capital stock would be smaller in the future, either because the owner did not replace the destroyed equipment or because replacing the equipment crowded out other investments that would have been made in the absence of climate change. The smaller capital stock would result in less production, which would decrease GDP in the future. The cumulative loss of GDP could thus exceed the initial \$50 million worth of damage.

Although CBO's projection reflects those types of direct and indirect effects, it does not fully capture all aspects of climate change that could affect GDP. The agency cannot determine whether the net effect of those aspects is positive or negative. For example, CBO's projection does not fully account for potential spillover effects on the U.S. economy from migration, social upheaval, and reduced economic performance in other countries owing to climate change. Those international spillovers could have positive effects on U.S. GDP (for example, an increase in the labor supply resulting from higher immigration rates) or negative effects on U.S. GDP (for example, a reduction in demand for U.S. exports). In addition, CBO's projection does not capture all the effects of rising sea levels on GDP (it captures the effects of storm surge damage but not the effects of inundation) or all the effects of investments made to adapt to the changing climate. Expenditures on such adaptations, such as seawalls, air conditioning, or irrigation systems, may boost GDP in the year that the spending occurs. However, investing in such measures could also crowd out other productive investments and thus reduce GDP in the future. Even investing in more climate-resilient versions of existing capital could increase costs without enhancing productivity. Finally, CBO's projection does not fully capture all the effects associated with adjusting to a new climate, such

1. For additional information, see Evan Herrnstadt and Terry Dinan, *CBO's Projection of the Effect of Climate Change on U.S. Economic Output*, Working Paper 2020-06 (Congressional Budget Office, September 2020), [www.cbo.gov/publication/56505](http://www.cbo.gov/publication/56505).

Box 1.

Continued

**Interpreting CBO’s Projection of the Effect of Climate Change on Economic Output**

as the movement of people away from regions of the country that have become uncomfortably hot or toward regions that have become more temperate.

**How Climate Change Affects People’s Well-Being Beyond GDP**

In addition to its effects on GDP, climate change would have other effects on people’s well-being—some positive and some negative. For example, GDP does not reflect the changes in people’s comfort because of milder winters and hotter summers, the risks and living constraints associated with increases in asthma from higher temperatures, increases in premature deaths from heat or tropical disease and decreases in cold-related premature deaths, or the potential disproportionate effects on disadvantaged communities if they are less able to adapt to climate change.

**Uncertainty in CBO’s Projection of the Effect of Climate Change on GDP**

CBO’s analysis of the effect of climate change on GDP is uncertain for many reasons. Some of those reasons relate to inherent uncertainty about the future, such as the following:

- Scientific uncertainty associated with projecting the diffusion of greenhouse gas emissions from the atmosphere into the oceans and biosphere; uncertainty in translating concentrations of greenhouse gases into changes in global climatic conditions, such as global temperatures, sea surface temperatures, and sea levels; and uncertainty in translating those conditions into changes in U.S. regional temperatures, precipitation patterns, hurricane frequencies, and sea levels.
- Uncertainty about the effects of climate change on the rest of the world and the resulting changes to the U.S. economy.
- Uncertainty associated with interactions between future climate change and economic growth. For example, the damage caused by future climate-induced changes in hurricane frequencies and sea levels would be amplified by coastal development.
- Uncertainty about how underlying economic and demographic factors, such as changes in population, income per person, energy use, and technology, will affect future greenhouse gas emissions.

Other sources of uncertainty relate to CBO’s modeling approach, such as these:

- Uncertainty in the estimates of the historical relationship between regional weather and regional output.
- Uncertainty about how closely those estimated historical relationships will map to the effects of future climate-determined weather patterns on future U.S. output (including uncertainty about the effects of adaptation), and interactive effects that may arise as different regions simultaneously experience (and adapt to) changes in weather.
- Uncertainty about the persistence of effects from damage, such as GDP losses from damage to capital.

**Changes in CBO’s Projection Method**

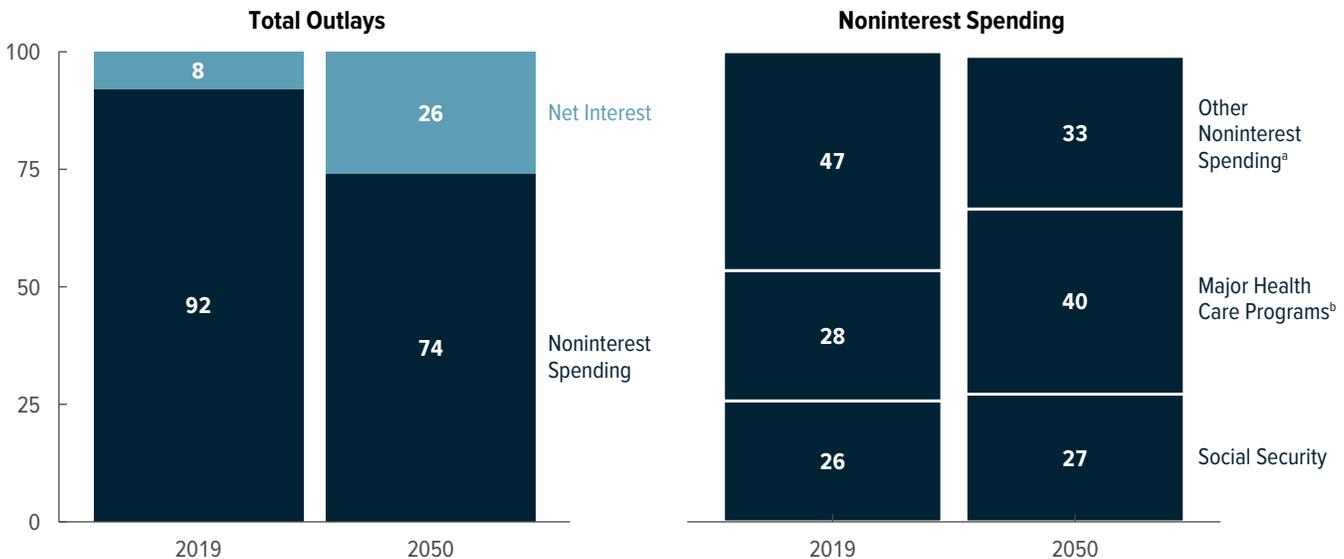
In past analyses, CBO’s economic projections incorporated the effect of climate change on the growth rate of real GDP through recent economic data that the agency used to develop its forecast, but the agency did not separately report that effect in its baseline projection of GDP. In light of recent academic research, the agency now expects that the negative effect on the GDP growth rate over the next 30 years will be larger than the rate implied by the effect of climate change on economic outcomes in the past 25 years. In the estimates presented in this report, the agency accounted for that larger negative effect of climate change on economic growth.

The 0.03 percentage-point reduction in the GDP growth rate that CBO projects reflects both the continuation of the recent effect of climate change on the real GDP growth rate and the impact of increases in that effect that are expected in the future. On its own, the continuation of recent effects of climate change on the growth rate would reduce the average real GDP growth rate from 2020 to 2050 by 0.01 percentage point, relative to the climatic conditions that prevailed at the end of the 20th century, lowering the level of real GDP in 2050 by 0.4 percent. In addition, CBO projects that the increased effects of climate change on real GDP growth will reduce the growth rate by another 0.02 percentage points, reducing the level of real GDP in 2050 by an additional 0.6 percent.

Figure 8.

**Composition of Federal Outlays**

Percent



Source: Congressional Budget Office.

a. Consists of all federal spending other than that for Social Security, the major health care programs, and net interest.

b. Consists of spending for Medicare (net of premiums and other offsetting receipts), Medicaid, and the Children's Health Insurance Program, as well as outlays to subsidize health insurance purchased through the marketplaces established under the Affordable Care Act and related spending.

in 2020 to 96 million in 2050, and spending for the program increases from 5.3 percent of GDP to 6.3 percent over that period (see Figure 9). Those projections reflect the assumption that Social Security will continue to pay benefits as scheduled under current law, regardless of the status of the program's trust funds.<sup>21</sup> That approach is consistent with a statutory requirement that CBO's 10-year baseline projections incorporate the assumption that funding for such programs is adequate to make all payments required by law.<sup>22</sup>

The Social Security program is funded by dedicated tax revenues from two sources. Currently, 96 percent of the funding comes from a payroll tax; the rest is collected

from income taxes on Social Security benefits. Revenues from the payroll tax and the tax on benefits are credited to the Old-Age and Survivors Insurance Trust Fund and the Disability Insurance Trust Fund, which finance the program's benefits. In CBO's extended baseline projections, dedicated tax revenues for the combined trust funds remain roughly constant, equaling 4.5 percent of GDP in 2050.

A common measure of the sustainability of a program that has a trust fund and a dedicated revenue source is its estimated actuarial balance over a given period—that is, the sum of the present value of projected tax revenues and the current trust fund balance minus the sum of the present value of projected outlays and a year's worth of benefits at the end of the period.<sup>23</sup> For Social Security,

21. The balances of the trust funds represent the total amount that the government is legally authorized to spend for those purposes. For more details about the legal issues related to exhaustion of a trust fund, see Barry F. Huston, *Social Security: What Would Happen If the Trust Funds Ran Out?* Report RL33514, version 31 (Congressional Research Service, July 29, 2020), <https://go.usa.gov/xEtw>.

22. Sec. 257(b)(1) of the Balanced Budget and Emergency Deficit Control Act of 1985 (Deficit Control Act), P.L. 99-177 (codified at 2 U.S.C. §907(b)(1) (2016)).

23. A present value expresses a flow of past and future income or payments as a single amount received or paid at a specific time. The value depends on the interest rate, known as the discount rate, used to translate past and future cash flows into current dollars at that time. To account for the difference between a trust fund's current balance and the desired balance at the end of the period, the balance at the beginning is added to the projected tax revenues, and an additional year of costs at the end of the period is added to projected outlays.

Table 3.

**Assumptions About Outlays and Revenues Underlying CBO’s Extended Baseline Projections**

<b>Assumptions About Outlays</b>	
Social Security	As scheduled under current law <sup>a</sup>
Medicare	As scheduled under current law through 2030; thereafter, projected spending depends on the estimated number of beneficiaries, the growth of potential GDP per person, and health care costs per beneficiary (for which excess cost growth is projected to move smoothly to a rate of 1 percent by 2050) <sup>a</sup>
Medicaid	As scheduled under current law through 2030; thereafter, projected spending depends on the estimated number of beneficiaries, the growth of potential GDP per person, and health care costs per beneficiary (for which excess cost growth is projected to move smoothly to a rate of 1 percent by 2050)
Children’s Health Insurance Program	As projected in CBO’s baseline through 2030; remaining constant as a percentage of GDP thereafter
Subsidies for Health Insurance Purchased Through the Marketplaces	As scheduled under current law through 2030; thereafter, projected spending depends on the estimated number of beneficiaries, an additional indexing factor for subsidies, the growth of potential GDP per person, and excess cost growth for private health insurance premiums (which is projected to move smoothly to a rate of 1 percent by 2050)
Other Mandatory Spending	As scheduled under current law through 2030; thereafter, refundable tax credits are estimated as part of revenue projections, and the rest of other mandatory spending is assumed to decline as a percentage of GDP at roughly the same annual rate at which it is projected to decline between 2026 and 2030 in the agency’s baseline published in March 2020
Discretionary Spending	As projected in CBO’s baseline through 2030; beyond that year, CBO projects that, after a five-year transition period, discretionary spending would grow at the rate of nominal GDP
<b>Assumptions About Revenues</b>	
Individual Income Taxes	As scheduled under current law
Payroll Taxes	As scheduled under current law
Corporate Income Taxes	As scheduled under current law
Excise Taxes	As scheduled under current law <sup>b</sup>
Estate and Gift Taxes	As scheduled under current law
Other Sources of Revenues	As scheduled under current law through 2030; remaining constant as a percentage of GDP thereafter

Source: Congressional Budget Office.

The extended baseline projections, which generally reflect current law, follow CBO’s 10-year baseline budget projections and then extend most of the concepts underlying those projections for the rest of the long-term projection period.

For CBO’s most recent 10-year baseline projections, see Congressional Budget Office, *An Update to the Budget Outlook: 2020 to 2030* (September 2020), [www.cbo.gov/publication/56517](http://www.cbo.gov/publication/56517).

Excess cost growth is the extent to which the growth rate of nominal health care spending per person (adjusted to remove the effects of demographic changes) exceeds the growth rate of potential GDP per person. (Potential GDP is the maximum sustainable output of the economy.)

GDP = gross domestic product.

- a. Assumes the payment of full benefits as scheduled under current law, regardless of the amounts in the program’s trust funds.
- b. The exception to the current-law assumption applies to expiring excise taxes dedicated to trust funds. The Balanced Budget and Emergency Deficit Control Act of 1985 requires CBO’s baseline to reflect the assumption that those taxes would be extended at their current rates. That law does not stipulate that the baseline include the extension of other expiring tax provisions, even if they have been routinely extended in the past.

Figure 9.

**Outlays and Revenues in Selected Years**

Percentage of Gross Domestic Product



Source: Congressional Budget Office.

- a. Consists of spending for Medicare (net of premiums and other offsetting receipts), Medicaid, and the Children’s Health Insurance Program, as well as outlays to subsidize health insurance purchased through the marketplaces established under the Affordable Care Act and related spending.
- b. Consists of all federal spending other than that for Social Security, the major health care programs, and net interest.
- c. Consists of excise taxes, remittances to the Treasury from the Federal Reserve System, customs duties, estate and gift taxes, and miscellaneous fees and fines.

Table 4.

**Summary Financial Measures for the Social Security System**

Projection Period (Calendar years)	Income Rate	Cost Rate	Actuarial Balance (Difference)
<b>As a Percentage of Gross Domestic Product</b>			
25 Years (2020 to 2044)	5.1	6.3	-1.2
50 Years (2020 to 2069)	4.8	6.3	-1.5
75 Years (2020 to 2094)	4.7	6.3	-1.6
<b>As a Percentage of Taxable Payroll</b>			
25 Years (2020 to 2044)	14.5	17.9	-3.4
50 Years (2020 to 2069)	14.0	18.4	-4.3
75 Years (2020 to 2094)	14.0	18.7	-4.7

Source: Congressional Budget Office.

These projections incorporate the assumption that spending for Social Security continues as scheduled even if its trust funds are exhausted. Through 2050, the projections incorporate the feedback from changes in economic variables caused by rising federal debt and marginal tax rates. After 2050, they do not account for such feedback.

Over each projection period, the income rate is the present value of annual tax revenues plus the initial trust fund balance, and the cost rate is the present value of annual outlays plus the present value of a year’s worth of benefits as a reserve at the end of the period, each divided by the present value of gross domestic product or taxable payroll. (The present value of a flow of revenues or outlays over time expresses that flow as a single amount received or paid at a specific time. The present value depends on a rate of interest, known as the discount rate, that is used to translate past and future cash flows into current dollars.) The actuarial balance is the difference between the income and cost rates.

that difference is traditionally expressed as a percentage of the present value of taxable payroll over 75 years.<sup>24</sup>

Because the trust funds’ revenues are projected to grow more slowly than their expenditures, the Social Security program has a long-term actuarial deficit. Over the next 75 years, if current laws remained in place, the program’s actuarial deficit would be 1.6 percent of GDP, or 4.7 percent of taxable payroll, CBO projects (see Table 4).<sup>25</sup> (The 75-year projection period used here begins in calendar year 2020 and ends in calendar year 2094.) Thus, according to CBO’s projections, the federal

government could pay the benefits prescribed by current law and maintain the necessary trust fund balances through 2094 if payroll taxes were raised immediately by about 4.7 percent of taxable payroll, if scheduled benefits were reduced by an equivalent amount, or if some combination of tax increases and spending reductions of equal present value was adopted.

A policy that either increased revenues or reduced outlays by the same percentage of taxable payroll each year to eliminate the 75-year shortfall would not necessarily place Social Security on a financial path that was sustainable beyond that period. Estimates of the actuarial deficit do not account for revenues or outlays after the 75-year projection period ends, and the gap between revenues and outlays would rise thereafter. Because projected shortfalls are smaller earlier in the period than they are later, such a policy would create surpluses in the next few decades but result in deficits later and would not leave the system on a sustainable financial path after calendar year 2094.

To put Social Security on a sustainable path beyond the 75th year, a policy would need to address the growing gap between revenues and outlays after that year. Even if a policy change was projected to make the system solvent

24. Taxable payroll is the total amount of earnings (wages and self-employment income) from employment covered by Social Security that is below the maximum amount subject to taxation (\$137,700 in 2020).

25. The Social Security trustees have estimated that the program’s 75-year actuarial shortfall would be 3.2 percent of taxable payroll, which is 1.5 percentage points less than CBO’s projection. The projections and analysis in the Social Security trustees’ report do not reflect the potential effects of the pandemic on the Social Security program. For details on the trustees’ projections, see Social Security Administration, *The 2020 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds* (April 2020), [www.ssa.gov/oact/trf/2020](http://www.ssa.gov/oact/trf/2020).

for the next 75 years, it might fail to do so or might exceed its goals because of unexpected changes in demographics or in the economy. Additionally, a substantial policy change would probably have economic effects and could alter the behavior of workers and beneficiaries. Those effects, which are not included in the calculation of the actuarial balance, could cause a policy change to fall short of or exceed its stated goals.

Another commonly used measure of Social Security's sustainability is the trust funds' dates of exhaustion. CBO projects that under current law, the DI trust fund would be exhausted in fiscal year 2026 and the OASI trust fund would be exhausted in calendar year 2031. If their balances were combined, the OASDI trust funds would be exhausted in calendar year 2031, CBO estimates. The total reduction in annual benefits necessary for the trust funds' outlays to match their revenues in each year after the OASDI trust funds were exhausted would be about 25 percent in 2032 and would rise to about 31 percent in 2050, in CBO's estimation.

**Major Health Care Programs.** Outlays for the major health care programs consist of spending for Medicare, Medicaid, and the Children's Health Insurance Program (CHIP), as well as outlays for premium tax credits and related spending.<sup>26</sup> Spending on Medicare, which provides health insurance to about 62 million people (most of whom are at least 65 years old), accounts for about three-fifths of that spending.

For 2020 through 2030, CBO projects federal spending for the government's major health care programs under the assumption that the laws governing those programs will, in general, remain unchanged. CBO assumes that Medicare will pay benefits as scheduled under current law (the same assumption it makes for Social Security), regardless of the amounts in the program's trust funds. For projections beyond 2030, CBO uses a formulaic approach that combines estimates of the number of expected beneficiaries of the government's health care programs with mechanical estimates of the growth in spending per beneficiary. (CBO chose that approach to

address the considerable uncertainty that surrounds the evolution of health care delivery and financing systems.)

Over the past five decades, spending for the major health care programs has grown faster than the economy, and that trend persists in CBO's extended baseline. In 2020, net federal spending for the major health care programs is estimated to equal 6.1 percent of GDP. If current laws generally remained in place, net outlays for those programs would increase to 9.2 percent in 2050: Medicare spending, net of offsetting receipts (mostly premiums paid by enrollees), would grow by 2.5 percent of GDP, and spending on Medicaid and CHIP, combined with outlays for premium tax credits and related spending, would grow by 0.6 percent of GDP (see Figure 10).<sup>27</sup>

### **Causes of Growth in Spending for Social Security and the Major Health Care Programs**

The aging of the population and rising health care costs per person are the primary reasons for the sharp rise in projected spending for Social Security and the major health care programs over the next 30 years. The extent to which health care costs per person (adjusted for demographic changes) grow faster than potential GDP per person is known as excess cost growth. In CBO's extended baseline projections, combined spending for Social Security and the major health care programs grows from 10.8 percent of GDP in 2019 to 17.0 percent in 2050 (see Figure 11).<sup>28</sup> Spending for Social Security increases from 4.9 percent of GDP in 2019 to 6.3 percent in 2050, and spending for the major health care programs rises from 5.9 percent of GDP to 10.7 percent.

In developing its projections, if CBO had set the shares of the population by age at the proportions for 2019 and had set excess cost growth at zero, projected spending for Social Security and the major health care programs as a share of GDP in 2050 would have been 10.6 percent instead of 17.0 percent as projected for 2050. That amount, 10.6 percent of GDP in 2050 without aging and excess cost growth, would be slightly lower than spending on those programs as a share of GDP in 2019,

26. Premium tax credits are federal subsidies for health insurance purchased through the marketplaces established by the Affordable Care Act. Related spending consists almost entirely of payments for risk adjustment and the Basic Health Program (an optional state program that covers low-income residents outside of the health insurance marketplaces).

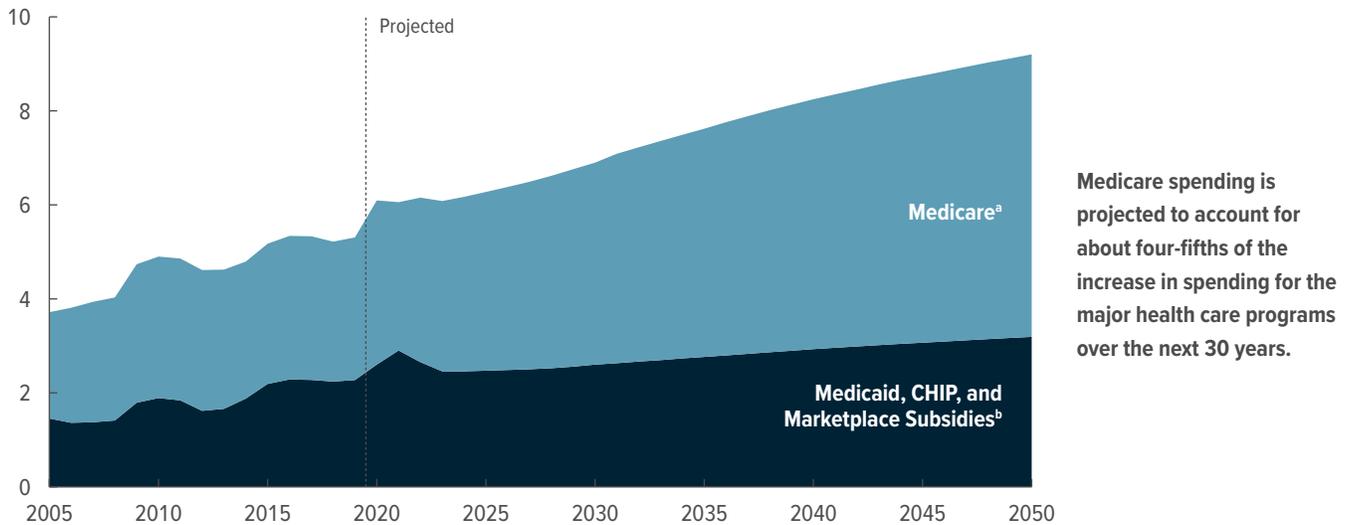
27. In CBO's projections, the outlays for subsidies for insurance purchased through the marketplaces and related spending are combined with outlays for Medicaid and CHIP. Federal subsidies for health insurance for low- and moderate-income households account for most of those outlays.

28. This analysis of the causes of spending growth encompasses gross spending on Medicare and does not reflect receipts credited to the program from premiums and other sources.

Figure 10.

**Federal Outlays for the Major Health Care Programs, by Category**

Percentage of Gross Domestic Product



Medicare spending is projected to account for about four-fifths of the increase in spending for the major health care programs over the next 30 years.

Source: Congressional Budget Office.

CHIP = Children’s Health Insurance Program.

a. “Medicare” refers to spending for Medicare net of premiums and other offsetting receipts.

b. “Marketplace Subsidies” refers to spending to subsidize health insurance purchased through the marketplaces established under the Affordable Care Act and related spending.

which is 10.8 percent of GDP.<sup>29</sup> However, taking into account the aging of the population and rising health care costs per person boosts projected spending for Social Security and the major health care programs by 6.5 percentage points in 2050. Of that difference, the aging of the population accounts for 3.1 percentage points, or about half. Excess cost growth accounts for the remaining 3.4 percentage points of the difference.

**Aging of the Population.** In CBO’s projections, the aging of the baby-boom generation (people born between 1946 and 1964) and improved life expectancy increase

the share of the population that is age 65 or older from 16 percent to 22 percent between 2019 and 2050.<sup>30</sup>

Aging accounts for more than the projected increase in Social Security spending as a percentage of GDP. In other words, if not for the aging of the population, spending on Social Security as a share of the economy would decline from 4.9 percent of GDP in 2019 to 4.7 percent of GDP in 2050. Because the share of the population that is 65 or older is growing, however, a larger segment of the population will receive Social Security benefits, boosting federal spending for the program. Taking that factor into account, CBO projects that

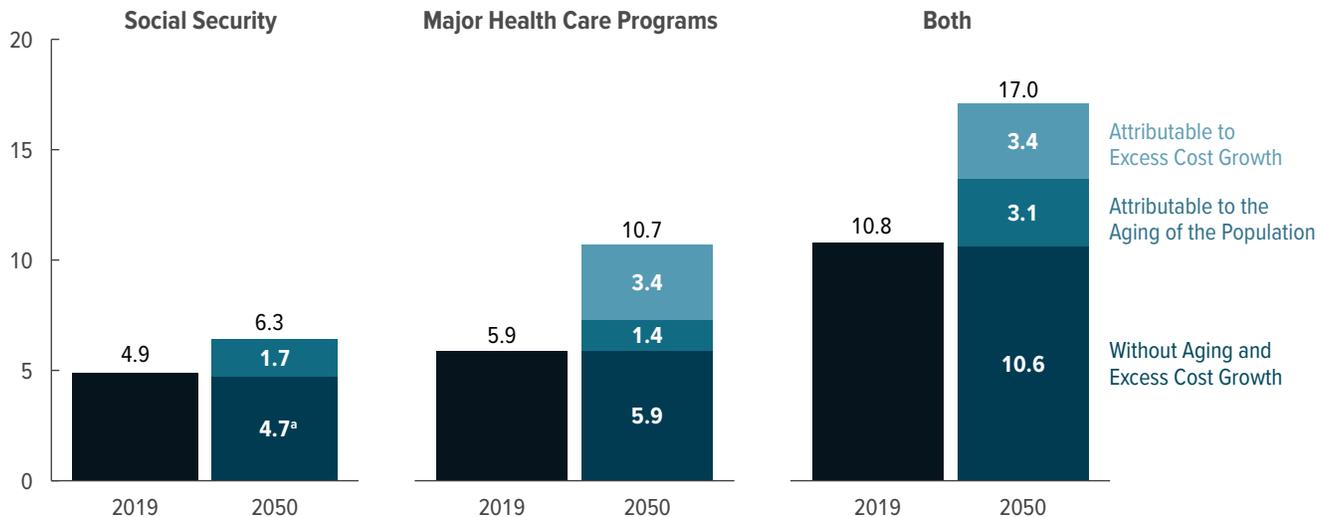
29. If the effects of aging and excess cost growth were removed, spending on Social Security as a percentage of GDP would be smaller in 2050 than it was in 2019, mainly because of the scheduled increases in the full retirement age for Social Security. For more details about the full retirement age for Social Security, see Zhe Li, *The Social Security Retirement Age*, Report R44670, version 11 (Congressional Research Service, September 13, 2019), <https://go.usa.gov/xGnEx>.

30. The youngest baby boomers will reach age 65 in 2029. Their retirement is projected to put upward pressure on Social Security spending, and that pressure will be greater over the next 10 years than over the remainder of the projection period. CBO projects that Social Security spending would increase from 4.9 percent of GDP in 2019 to 6.0 percent by 2030. Spending for the program would continue to grow through 2050 (to 6.3 percent of GDP), although not as quickly as it did between 2019 and 2030.

Figure 11.

**Spending for Social Security and the Major Health Care Programs in 2019 and 2050**

Percentage of Gross Domestic Product



Source: Congressional Budget Office.

Spending for the major health care programs consists of gross spending for Medicare (which does not account for offsetting receipts and premiums), Medicaid, and the Children's Health Insurance Program, as well as outlays to subsidize health insurance purchased through the marketplaces established under the Affordable Care Act and related spending.

Excess cost growth is the extent to which the growth rate of nominal health care spending per person (adjusted for demographic changes) exceeds the growth rate of potential GDP per person. (Potential GDP is the maximum sustainable output of the economy.)

GDP = gross domestic product.

a. If aging did not occur after 2019, spending on Social Security as a share of GDP would be lower in 2050, mainly because of the scheduled increases in the full retirement age for Social Security.

spending on Social Security as a share of the economy would increase to 6.3 percent of GDP in 2050.

Over the 2019–2050 period, aging accounts for about one-third of the projected increase in spending, relative to GDP, for the major health care programs in total. The effects of aging on spending for Medicare are the most significant driver of the effects of aging on spending for the health care programs overall, because Medicare is the largest such program, and most beneficiaries qualify for it at age 65. As that group becomes larger and older, on average, Medicare spending will increase, not only because the number of beneficiaries will rise but also because people tend to require more health care as they age.

**Rising Health Care Costs per Person.** Even though growth in health care costs per person has slowed recently, over the next 30 years such costs are projected to continue to grow faster than potential GDP per

person. From 2020 through 2050, the average rate of excess cost growth in CBO's projections is 1.2 percent for Medicare and 1.5 percent for Medicaid. In the agency's extended baseline projections, excess cost growth accounts for about two-thirds of the increase in spending, measured as a share of GDP, for the major health care programs between 2019 and 2050.

### Other Noninterest Spending

In CBO's extended baseline projections, total federal spending for all programs and activities other than Social Security, the major health care programs, and net interest costs reaches a historically high level in 2020 and then declines as a share of GDP to its lowest level in more than 70 years (see Figure 9 on page 28). Over the past 50 years, such spending has averaged 11 percent of GDP, but it has been as high as 14 percent (in the late 1960s and early to mid-1970s) and as low as 8 percent (in the late 1990s and early 2000s). Other noninterest spending is projected to increase in 2020 to 19.0 percent

of GDP as a result of the laws enacted in response to the pandemic. CBO projects that, under current law, such spending would fall to 8.0 percent of GDP in 2030 and to 7.6 percent of GDP in 2050. Discretionary spending is projected to decline in relation to GDP over the next 10 years and assumed to stay roughly constant from 2030 to 2050, while mandatory spending excluding that for Social Security and the major health care programs (referred to as other mandatory spending) is projected to decline in relation to GDP over the next 30 years.

**Discretionary Spending.** About half of all discretionary spending is dedicated to national defense, and the rest is for an array of federally funded activities and programs, including education, transportation, housing assistance, veterans' health care, health-related research and public health programs, the administration of justice, and international affairs.

CBO estimates that discretionary outlays will increase to 8.0 percent of GDP in 2020, stemming from the policies put in place to counter the pandemic-related economic disruption. (Over the past half-century, those outlays diminished from 11.5 percent in 1970 to 6.3 percent in 2019.) In CBO's baseline projections, discretionary outlays decrease steadily from 7.6 percent of GDP in 2021 to 5.8 percent in 2030.

Through 2021, most discretionary funding is limited by caps on annual discretionary appropriations that were specified in the Bipartisan Budget Act of 2019 (P.L. 116-37). In CBO's projections, the decline in discretionary outlays relative to GDP over the following nine years reflects the statutory limits on discretionary funding in 2021 and CBO's assumption (required by law for its 10-year baseline projections) that discretionary funding will grow at the rate of inflation—which is slower than the projected growth of nominal GDP—beginning in 2022.<sup>31</sup>

31. In accordance with section 257 of the Deficit Control Act, CBO projects budget authority over the 10-year period by applying the specified inflation rate to the most recent appropriations for discretionary accounts. Because of the unusual size and nature of the emergency funding provided in recently enacted legislation in response to the pandemic, CBO, in consultation with the House and Senate Committees on the Budget, deviated from the standard procedures for constructing its current extended baseline and did not extrapolate the discretionary budget authority provided by the three laws responding to the pandemic that were enacted after March 6, 2020.

After 2030, in CBO's projections, discretionary spending transitions over a five-year period from growing with the rate of inflation to growing with nominal GDP. Beyond 2035, CBO's extended baseline projections reflect the assumption that discretionary spending will grow with nominal GDP and remain constant at 5.6 percent of GDP through 2050 (see Figure 12).<sup>32</sup>

**Other Mandatory Spending.** Since the mid-1960s, mandatory spending excluding that for Social Security and the major health care programs has generally remained between 2 percent and 4 percent of GDP. That category of spending includes outlays for SNAP, unemployment compensation, retirement programs for federal civilian and military employees, certain veterans' programs, Supplemental Security Income, and certain refundable tax credits.<sup>33</sup>

Other mandatory spending is projected to equal 11.0 percent of GDP in 2020 and 3.7 percent in 2021, an increase from its value of 2.7 percent in 2019, mainly because of policies enacted in response to the pandemic and associated economic downturn. For the rest of the 10-year period, such spending declines gradually as a share of the economy, reaching 2.3 percent of GDP in 2030.<sup>34</sup> The projected decline occurs in part because benefit amounts for many of those programs are adjusted for inflation each year, and inflation in CBO's economic forecast is estimated to be less than the rate of growth in nominal GDP.

In CBO's extended baseline projections, other mandatory spending falls to 2.0 percent of GDP by 2050. In part, that reduction is attributable to growth in income, which decreases the number of people who qualify for refundable tax credits. That reduction also reflects the

32. Although discretionary spending declines in relation to GDP from 2020 to 2030 in CBO's projections, the agency does not expect it to decline further. That is because discretionary spending has historically been a larger share of economic output than it is projected to be in 2030.

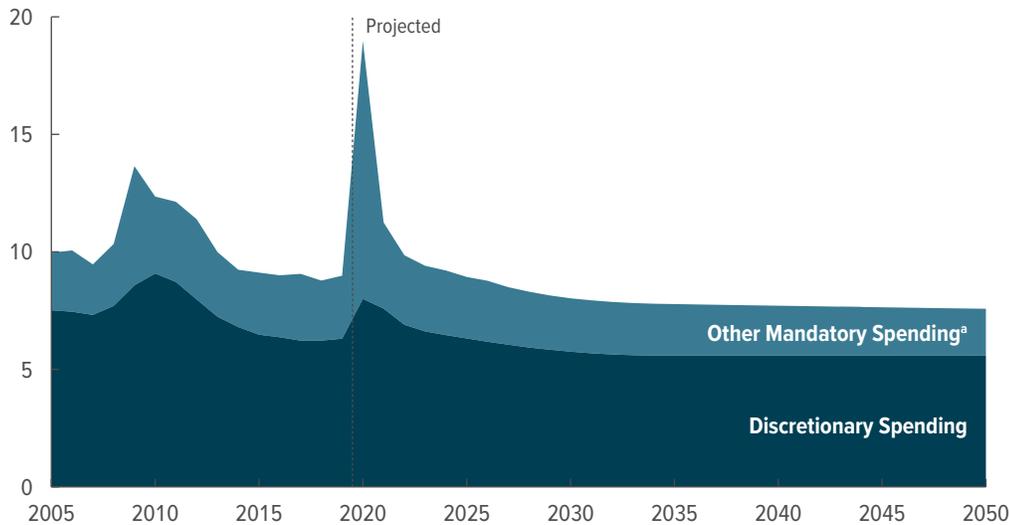
33. Refundable tax credits reduce a filer's overall income tax liability; if the credit exceeds the rest of the filer's income tax liability, the government pays all or some portion of that excess to the taxpayer (and the payment is treated as an outlay in the budget). See Congressional Budget Office, *Refundable Tax Credits* (January 2013), [www.cbo.gov/publication/43767](http://www.cbo.gov/publication/43767).

34. Sec. 257(b)(2) of the Deficit Control Act, which governs CBO's baseline projections, makes exceptions regarding current law for some programs, such as SNAP, that have expiring authorizations but that are assumed to continue as currently authorized.

Figure 12.

**Other Federal Noninterest Spending**

Percentage of Gross Domestic Product



Over the long term, other federal noninterest spending, measured as a percentage of economic output, declines in CBO's projections.

Source: Congressional Budget Office.

a. Consists of all mandatory spending other than that for Social Security and the major health care programs. It includes the refundable portions of the earned income tax credit, the child tax credit, and the American Opportunity Tax Credit.

assumption that after 2030 other mandatory spending, excluding outlays for such tax credits, declines at roughly the same rate by which it is projected to fall between 2026 and 2030.<sup>35</sup>

**Net Interest Costs**

Over the past 50 years, the government's net interest costs have averaged 2.0 percent of GDP, although they have been as high as 3.2 percent and as low as 1.2 percent. Over the first half of the next decade, in CBO's projections, net interest costs as a share of the economy decrease from 1.6 percent of GDP in 2020 to 1.1 percent in 2025 because of continued low interest rates. Those costs increase to 2.2 percent by 2030 as greater federal borrowing boosts debt-service costs and as interest rates rise. Net interest costs reach 8.1 percent of GDP by 2050—higher than they have ever been (see Figure 9 on page 28). If net interest costs followed

that projected path, they would exceed other mandatory spending by 2031, exceed all discretionary spending by 2043, surpass spending for Social Security by 2046, and be larger than any single program by 2050.

Over the long term, deficits and debt rise in CBO's projections because of the growing gap between spending and revenues, and higher interest costs are a major contributor to the growth of that gap. Net interest costs are projected to increase from an average of 6 percent of total spending in the first decade (2020 to 2030) to more than one-fifth in the third decade (2041 to 2050). Moreover, net interest costs account for about one-quarter of the total deficit in the first decade and about three-fifths in the third decade. In large part, those rising interest costs result from increases in interest rates that reflect long-term economic trends, which CBO projects would occur even if debt did not grow beyond its current level. But greater federal borrowing places additional upward pressure on interest rates and thus on interest costs. Moreover, growth in interest costs and growth in debt reinforce one another: Rising interest costs boost deficits and debt, and rising debt pushes up interest costs.

35. For years after 2030, CBO did not project other mandatory spending in detail because of the many programs involved and the various factors that influence spending on them. Instead, CBO projected that spending for those programs (except for certain refundable tax credits) would decline as a share of GDP in the later decades at roughly the same annual rate at which it is projected to decline between 2026 and 2030 in the agency's baseline published in March 2020.

## Projected Revenues Through 2050

In CBO's extended baseline projections, revenues measured as a share of GDP are generally higher than they have been, on average, in recent decades. Revenues have averaged 17.4 percent of GDP over the past 50 years, but they have fluctuated between 15 percent and 20 percent of GDP over that period because of changes in tax laws and interactions between those laws and economic conditions.

CBO projects a sharp decline in revenues in 2020 and 2021, reflecting the economic disruption caused by the pandemic and the federal government's response to it, including the enactment of legislation. If current laws generally remained unchanged, revenues would grow for the remainder of the decade. After declining from 16.3 percent in 2019 to 15.5 percent in 2021, total revenues as a share of GDP are projected to reach 17.3 percent in 2025. Largely because of scheduled increases in taxes resulting from the expiration of certain provisions of the 2017 tax act that affect individual income taxes, revenues are projected to rise after 2025, reaching 17.8 percent of GDP by 2030.

CBO's revenue projections are based on the assumption that the rules for all tax sources (individual income taxes, corporate income taxes, payroll taxes, and other taxes) will change only as scheduled under current law.<sup>36</sup> In CBO's extended baseline projections, revenues continue to grow faster than GDP after 2030 and total 18.6 percent of GDP in 2050.

Increases in receipts from individual income taxes account for most of the projected 2.7 percentage-point rise in total revenues as a share of GDP from 2020 to 2050. Revenues from corporate income taxes also rise relative to GDP over that period, whereas revenues from payroll taxes and other sources decline (see Figure 9 on page 28).

## Reasons for the Growth in Revenues

The underlying causes of the projected increase in total revenues as a share of GDP over the 30-year period are real bracket creep in the individual income tax system,

36. The sole exception is expiring excise taxes dedicated to trust funds. The Deficit Control Act requires CBO's baseline to reflect the assumption that those taxes would be extended at their current rates. That law does not stipulate that the baseline include the extension of other expiring tax provisions, even if lawmakers have routinely extended them in the past.

scheduled increases in taxes, expiring temporary tax provisions, and other factors (see Figure 13).

**Real Bracket Creep.** The largest contributor to the increase in total revenues over the next three decades is real bracket creep, which occurs when income grows faster than inflation, as typically happens during economic expansions. If current laws generally remained unchanged, real bracket creep would continue to gradually push up taxes in relation to income through 2050, CBO projects, thereby increasing tax receipts. Even though most income tax brackets, exemptions, credits, and other tax thresholds are indexed to inflation, more income is pushed into higher tax brackets, and credits are phased out when income growth exceeds the rate of inflation.<sup>37</sup> Between 2030 and 2050, the share of income taxed at the top rate of 39.6 percent would rise by 2 percentage points—and the share of income excluded from taxation would fall by 3 percentage points—because of real bracket creep (see Figure 14).<sup>38</sup>

**Scheduled Increases in Taxes After 2025.** Another factor pushing up taxes relative to income is the scheduled expiration after calendar year 2025 of nearly all provisions of the 2017 tax act that affect individual income taxes. The provisions that are scheduled to expire include lower statutory tax rates, the higher standard deduction, the repeal of personal exemptions, and the expansion of the child tax credit.<sup>39</sup> Those expirations would cause tax liabilities to rise in calendar year 2026, boosting individual income tax receipts relative to GDP by 0.9 percentage points between 2020 and 2030.

**Other Factors.** Many other factors affect revenues—but to a lesser extent—in the extended baseline projections. Initially, temporary tax provisions enacted in response to the pandemic and associated economic disruption are expected to significantly reduce receipts in 2020 and 2021. The expiration of those temporary provisions,

37. Some parameters of the tax system, including the amount of the child tax credit, are fixed in nominal dollars and are not adjusted for inflation.

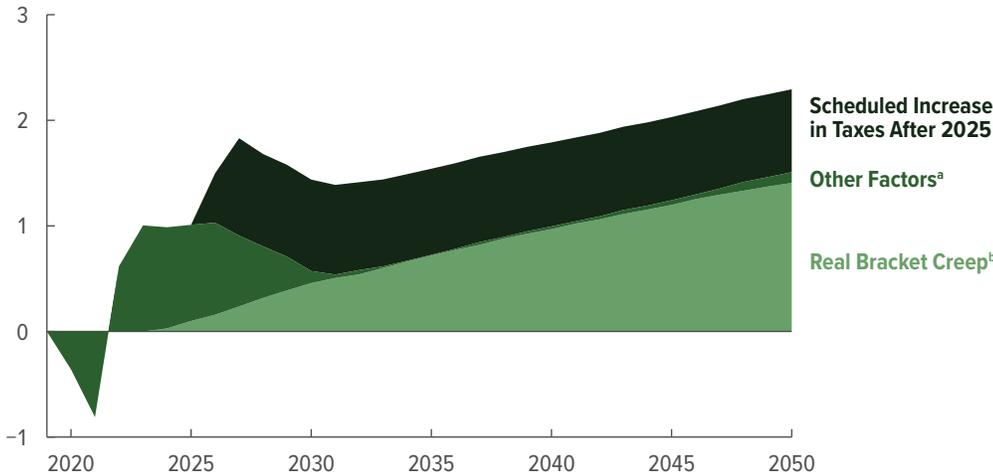
38. For more details, see Congressional Budget Office, "How Income Growth Affects Tax Revenues in CBO's Long-Term Budget Projections" (presentation, June 2019), [www.cbo.gov/publication/55368](http://www.cbo.gov/publication/55368).

39. Rules allowing accelerated depreciation deductions for certain business investments, which are scheduled to phase out between 2022 and 2027, are not included here.

Figure 13.

## Changes in Revenues

Percentage of Gross Domestic Product



Revenues are projected to decline sharply in 2020 and 2021 and then rebound over the next few years, reflecting the economic disruption caused by the pandemic and the federal government's response to it. Projected revenues rise sharply following the expiration at the end of 2025 of certain temporary provisions of the 2017 tax act and then resume steady growth.

Source: Congressional Budget Office.

- a. Other factors include temporary tax provisions enacted in response to the pandemic, which reduce revenues in 2020 and 2021, as well as factors that affect revenues over the longer term, such as the aging of the population, changes in the distribution of wages, and growth in nontaxable compensation as a result of rising costs for health care.
- b. Real bracket creep is the process in which, as income rises faster than inflation, a larger proportion of income becomes subject to higher tax rates.

taken together, is projected to boost receipts as a share of GDP by 1.3 percentage points between 2020 and 2030.

A different set of factors affects revenues over the longer term. One of those factors is taxable retirement income, which tends to grow more rapidly than GDP as the population ages. CBO expects the retirement of members of the baby-boom generation to cause a gradual increase in distributions from tax-deferred retirement accounts and traditional defined benefit pension plans, as well as taxable Social Security benefits.

A second factor is change in the distribution of earnings. Earnings are projected to grow faster for higher-earning people than for other people over the next 30 years. That trend would cause a larger share of individual earnings to be taxed at higher rates. However, the resulting increase in individual income tax revenues would be largely offset by a decrease of nearly the same amount in payroll tax receipts, CBO projects, because the share of earnings above the maximum amount subject to Social Security payroll taxes would grow. Workers do not accrue additional Social Security benefits for earnings above the maximum taxable amount. For a given total amount of

earnings, therefore, an increase in the share above the limit would reduce overall future benefit payments.

A third factor is growth in health care costs, which is projected to reduce revenues as a share of GDP over the next three decades. The share of employees' compensation that is paid in the form of wages and salaries, which are subject to income and payroll taxes, is projected to decline because of rising spending on fringe benefits (such as employment-based health insurance), which are not taxable. That shift in compensation would decrease taxable income—and thus revenues from both income and payroll taxes—relative to GDP.

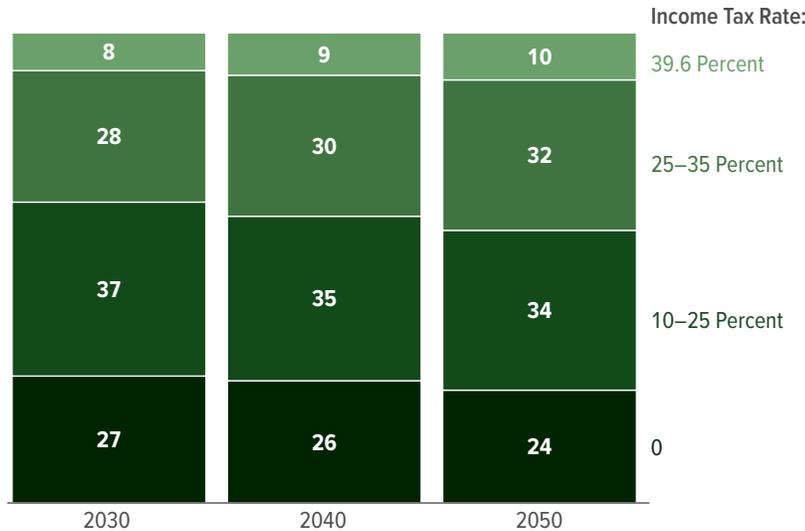
### Implications for Effective Tax Rates

Taken together, those factors would, under current law, cause the tax system in 2050 to differ substantially from the system today. On average, taxpayers across the income distribution would pay more of their income in taxes in 2050 than similar taxpayers do now if current laws generally remained unchanged. Furthermore, a larger share of each additional dollar of income that households earned would go toward taxes because the effective marginal federal tax rate on labor would rise (see

Figure 14.

**Shares of Income Taxed at Different Rates Under the Individual Income Tax System**

Percent



The largest contributor to growth in revenues over the next 30 years is real bracket creep. That is the process in which, as income rises faster than inflation, a larger proportion of income becomes subject to higher tax rates. As the share of income taxed at higher rates grows, the share exempt from taxation shrinks.

Source: Congressional Budget Office.

In this figure, income refers to adjusted gross income—that is, income from all sources not specifically excluded by the tax code, minus certain deductions. The income tax rate is the statutory rate specified under the individual income tax system. The lowest statutory tax rate is zero (because of deductions and exemptions).

Table 5). The effective marginal tax rate on capital would also rise but by a smaller amount. Higher marginal rates would dampen economic activity and investment by reducing people’s incentives to work and save.<sup>40</sup>

**Sensitivity of Budget Projections to Changes in Underlying Economic Factors**

CBO’s budget projections depend on its projections of economic factors, including economic growth and interest rates. To assess the sensitivity of its budget projections to those changes, CBO analyzed how its budget projections would change if productivity growth and interest rates were higher or lower (see Figure 15).<sup>41</sup>

40. Although the marginal tax rate on capital income is projected to rise under current law, it would still be lower than it has been in recent years.

41. In most years, CBO examines budgetary outcomes under both the extended baseline and an extended alternative fiscal scenario, under which current law would be changed to maintain certain policies that are now in place. Although CBO examines budgetary outcomes for the extended baseline only in this report, the agency expects to examine such outcomes under both the

**Growth of Nonfarm Business Productivity**

CBO examined the sensitivity of its projection of federal debt to changes in the growth rate of total factor productivity in the nonfarm business sector. The agency projected economic and budgetary outcomes using rates of growth for nonfarm business TFP that were 0.5 percentage points higher and 0.5 percentage points lower than the rate underlying the extended baseline projections. The range reflects the variation of about three-quarters of a percentage point in average TFP growth over 30-year periods between 1950 and the present and also the fact that such variation represents only some of the uncertainty about CBO’s projection of TFP growth.

- If nonfarm business productivity grew 0.5 percentage points faster than CBO projects, federal debt held by the public would be 155 percent of GDP in 2050 rather than 195 percent, as it is in the extended baseline projection.

extended baseline and an alternative fiscal scenario in the next report in this series.

Table 5.

### Effective Marginal Federal Tax Rates Underlying CBO's Extended Baseline Projections

Percent	2020	2030	2050
Marginal Tax Rate on Labor Income	27.3	30.4	31.9
Marginal Tax Rate on Capital Income	15.7	17.4	15.9

Source: Congressional Budget Office.

The extended baseline projections, which generally reflect current law, follow CBO's 10-year baseline budget projections and then extend most of the concepts underlying those projections for the rest of the long-term projection period.

The effective marginal federal tax rate on labor income is the share of an additional dollar of such income that is paid in federal individual income taxes and payroll taxes, averaged among taxpayers, with weights proportional to their labor income. The effective marginal federal tax rate on capital income is the share of the return on an additional dollar of investment made in a particular year that will be paid in taxes over the life of that investment. The before- and after-tax rates of return used to calculate that effective tax rate are weighted averages of the rates for every combination of asset type, industry, form of organization, and source of financing; the weights used are the asset values for each combination.

- If nonfarm business productivity grew 0.5 percentage points more slowly than projected, federal debt held by the public would be 239 percent of GDP in 2050.

### Interest on Federal Debt Held by the Public

CBO also examined the sensitivity of its projections of the federal debt to changes in interest rates within a range of 2 percentage points. Thus, CBO projected economic and budgetary outcomes using interest rates on federal debt that were 1.0 percentage point higher (before accounting for macroeconomic effects) and 1.0 percentage point lower than the agency's central estimates.

- If federal borrowing rates were 1.0 percentage point higher than CBO projects, federal debt held by the public would be 264 percent of GDP in 2050 rather than the 195 percent in the extended baseline projection.
- If federal borrowing rates were 1.0 percentage point lower than in CBO's extended baseline projections, federal debt held by the public would be 149 percent of GDP in 2050.

### Uncertainty of CBO's Long-Term Projections

Budget projections are inherently uncertain. Even if future tax and spending policies did not vary from those specified in current law, budgetary outcomes would undoubtedly differ from those in CBO's extended baseline projections because of unexpected changes in demographics, the economy, and other factors. In previous years, CBO has examined how its budget projections would change if a set of key factors—several demographic and economic factors and the growth of health care costs—together deviated from the paths underlying those projections, and the agency has examined other sources of uncertainty in detail.<sup>42</sup> In order to release this report when it would be most useful to the Congress, CBO examines budgetary outcomes for the extended baseline only in this report. Those projections represent the middle of the distribution of possible outcomes, in CBO's assessment.

Because of the current pandemic, the projections in this report are subject to an unusually high degree of uncertainty. That uncertainty stems from many sources, including changes to demographics (how the pandemic will affect rates of fertility, net immigration, and mortality), the economy (how the pandemic will affect economic growth and interest rates), and health care expenditures (how the pandemic will shift the demand for and supply of health care services). Uncertainty also surrounds the effectiveness of monetary and fiscal policy and the response of global financial markets to the substantial projected increases in public deficits and debt. The agency expects to examine uncertainty in its projections in greater depth in the next report in this series.

### Changes From Last Year's Long-Term Budget Outlook

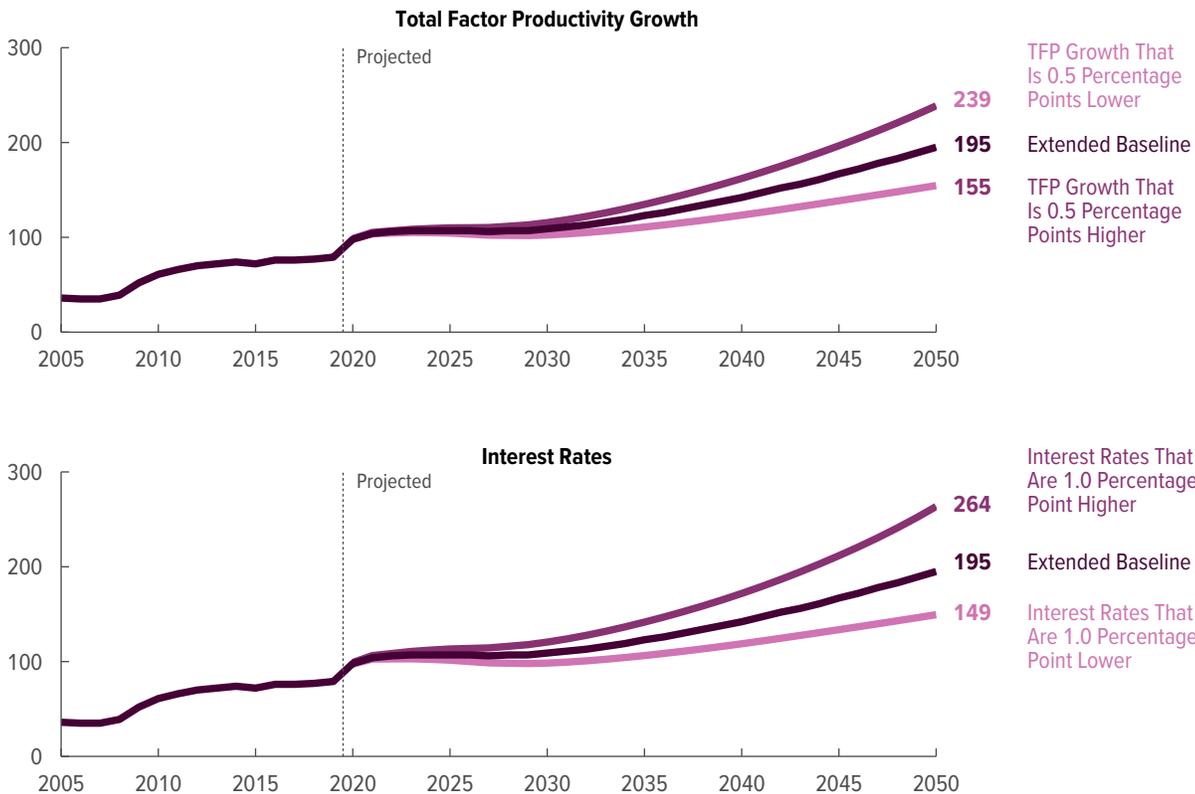
As a share of GDP, federal debt and deficits are now projected to be greater over the next three decades than CBO projected last year. In the agency's current extended baseline projections, debt reaches 189 percent of GDP in 2049, which is 45 percentage points higher than the amount the agency projected last year. In addition, projected primary and total deficits as a share of GDP in this year's report are larger throughout most of the projection period than those in last year's report. (See Appendix B

42. See Congressional Budget Office, *The 2019 Long-Term Budget Outlook* (June 2019), [www.cbo.gov/publication/55331](http://www.cbo.gov/publication/55331), and *The 2016 Long-Term Budget Outlook* (July 2016), [www.cbo.gov/publication/51580](http://www.cbo.gov/publication/51580).

Figure 15.

### Federal Debt if Total Factor Productivity Growth or Interest Rates Differed From the Values Underlying CBO’s Projections

Percentage of Gross Domestic Product



Source: Congressional Budget Office.

Total factor productivity growth is the growth of real output per unit of combined labor and capital services in the nonfarm business sector. The interest rate is the effective rate on federal debt.

TFP = total factor productivity.

for more information on the changes in CBO’s long-term budget projections since last year.)

Higher projected outlays and lower projected revenues at the beginning of the 30-year period contribute significantly to those upward revisions to the agency’s projected deficits. The increase in those deficits results primarily from the effects of the pandemic and actions taken to respond to it. Partially offsetting those changes is net spending for interest on the debt, which is now projected to be lower through 2033 than in last year’s projections. Net spending for interest rises faster through the end of the projection period than it was projected to in last year’s report, however, as greater federal borrowing

increases average interest rates on that debt. In addition, over the next three decades discretionary spending is higher than it was projected to be last year, primarily because of higher caps on discretionary funding in 2020 and 2021 put in place by the Bipartisan Budget Act of 2019 and the projected growth from the higher 2021 amount. Revenues are projected to be lower than they were in last year’s projections because of legislative changes, such as the repeal of the tax on employment-based health insurance plans with high premiums and a reduction in the projected rate of real bracket creep stemming from the downward revision to the agency’s projections of economic growth.

